we make it easy

ENERFLEX SYSTEMS INCOME FUND
2006 ANNUAL REPORT

for our customers

table of contents

annual general meeting

Unitholders of Enerflex Systems Income Fund are invited to attend the Annual General Meeting which will be held on April 12, 2007 at the Calgary Petroleum Club, 319-5th Avenue SW, Calgary, Alberta, at 4:00 p.m. Calgary time. Those unable to attend are encouraged to sign and return the proxy form mailed to them.

to deliver energy

Enerflex Systems Income Fund is a leading provider of products and services to the global oil and gas production industry.

Through three business segments, five divisions, over 2,800 dedicated employees, a strong balance sheet and sound strategy for continued growth, Enerflex is recognized as a global provider of an extensive range of energy products and services with a long standing reputation for quality and service.

Enerflex provides natural gas compression, power generation, process equipment and hydrocarbon production and processing facilities for sale, rent or lease; electrical instrumentation and controls services; and a comprehensive package of mechanical field maintenance and contracting capabilities.

Enerflex provides these products and services in an integrated package or as stand-alone offerings – all part of a unique value proposition for Enerflex customers.

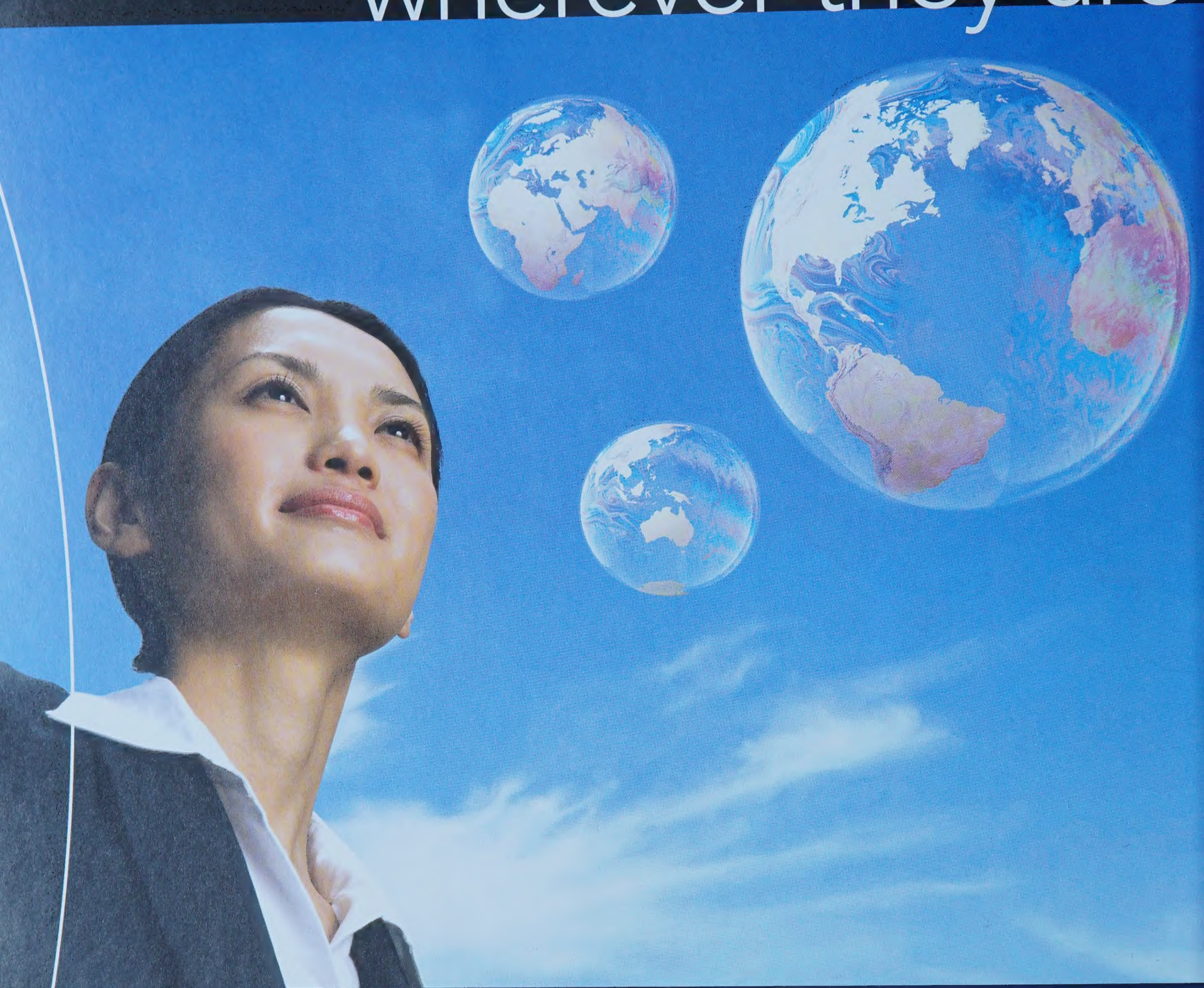
wherever they are

in the production chain

From design and engineering to construction and commissioning, ongoing maintenance, contract operating and optimization, we recognize there is a significant, largely unrealized potential to integrate these products and services to deliver new offerings. We have the people and capability to handle projects large and small, conventional and unconventional, onshore and offshore, wherever they are in the production chain.

Our proven strategies of growing domestically through initiatives such as Variable Cost Production and Flue Gas Recovery Technology; expanding our international footprint through Enerflex Global, Regionalization and Product Export; and improving our Business Performance, we are well positioned to sustain long-term value for our unitholders.

wherever they are



in the world

From high horsepower compression successfully installed in Australia, turnkey gas processing facilities operating in Pakistan, low horsepower screw compressors assembled in Canada and flare systems constructed for the United Arab Emirates, Enerflex is a leading provider of products and services to the global hydrocarbon production industry.

Our successful international strategy requires the continual execution of three important components.

Enerflex Global, our first key component, provides seamless total project solutions for international customers through a single point of contact. As a single-source provider of turnkey systems, Enerflex Global is responsible for integrating engineered systems for natural gas production and oil processing facilities from concept to operation. From analysis and engineering through fabrication, logistics, transportation, installation, commissioning and operation, our professionals are focused on increasing our international footprint.

This component has proven successful with the recent completion of large turnkey projects in Pakistan and Egypt.

the ENERFLEX world

The second key component is the Regionalization of our business into four key geographic areas with established infrastructure and local management teams. This results in a faster response time to our customers' needs and a better understanding of local market conditions and opportunities.

Our Regionalization efforts have proven successful with our AustralAsia Region contributing $154 million in revenue in 2006 – an increase of 139% over 2005. Through the expansion into our new Brisbane facility, we have significantly increased our profile and improved our competitive advantage for meeting the expanding natural gas infrastructure needs in that Region. In 2006, we also established an engineering office in Kuala Lumpur to provide cost effective, front end engineering support in the AustralAsia Region.

at a glance

The recent acquisition of the assets of Powertec Beheer B.V. ("Powertec") in the Netherlands in early 2007 has substantially increased our footprint and critical mass in Europe which clearly establishes our second international Region outside North America.

The third key component is Product Export which increased by 24% from 2005 to 2006. The opportunity to export products manufactured in Canada to support Enerflex Global and Regionalization is expanding. We will continue to build momentum and strategically position ourselves to take full advantage of an international market that represents meaningful growth potential.

understanding

financial snapshot

For the years ended December 31, *(Thousands of dollars, except percent and per share/unit amounts) (Unaudited)*	**2006**	2005
Revenue	**$ 792,330**	$ 670,612
Gross margin	**175,270**	145,945
Earnings before interest and income taxes	**66,591**	65,256
Net income	**40,751**	40,092
EBITDA[1]	**86,715**	81,395
EBITDA-adjusted[2]	**96,428**	81,395
Earnings per unit (basic)	**$ 0.89**	$ 0.89
Earnings per unit (diluted)	**$ 0.89**	$ 0.89
Dividends/distributions declared per unit	**$ 0.44**	$ 0.20
Distributable cash flow[1]	**50,192**	42,869
Distribution payout ratio[1]	**40%**	21%
Distributable cash flow – adjusted[2]	**57,773**	42,869
Distribution payout ratio – adjusted[2]	**35%**	21%
Financial Position		
Working capital	**$ 200,009**	$ 112,150
Total assets	**619,174**	564,315
Long-term debt	**133,557**	76,304
Unitholders' equity	**372,991**	329,257
Key Ratios		
Gross margin as a percentage of revenue	**22.1%**	21.8%
Pre-tax income as a percentage of revenue	**7.5%**	9.0%
Return on average equity	**11.6%**	12.8%

[1] EBITDA, distributable cash flow and distribution payout ratio are non-GAAP (Generally Accepted Accounting Principles) earnings measures that do not have a standardized meaning prescribed by GAAP and therefore are unlikely to be comparable to similar measures presented by other issuers.

[2] Amounts have been adjusted to reflect the impact of the costs incurred by Enerflex for the conversion to an income trust.

Revenue Up 18%

International Revenue Up 58%

The proposed reorganization of Enerflex into a Trust was the foundation of a plan to enhance shareholder value through the distribution of a portion of cash flow generated by the business of Enerflex on a tax-effective basis and to develop a platform for growth for all shareholders.

On September 27, 2006, Enerflex Systems Ltd. received 99.9% shareholder approval to convert to an income trust which was subsequently finalized on October 2, 2006 and resulted in the Company being renamed "Enerflex Systems Income Fund". On October 5, 2006, Enerflex Systems Income Fund units began trading on the Toronto Stock Exchange under the new symbol EFX.UN. The Company concurrently completed a two for one unit split.

our business

service

Provides Mechanical Service and Electrical Instrumentation & Controls

- Employs 46% of the staff
- Holds 31% of the assets
- Generates 37% of revenue
- Produces 35% of income before interest and income tax

($ millions)	**2006**	2005
Revenue	**$ 293.2**	$ 268.0
Gross Margin	**$ 82.4**	$ 74.6
EBITDA[1]	**$ 30.1**	$ 26.6

engineered systems

Provides Compression & Power and Production & Processing Equipment

- Employs 53% of the staff
- Holds 44% of the assets
- Generates 58% of revenue
- Produces 38% of income before interest and income taxes

($ millions)	**2006**	2005
Revenue	**$ 463.2**	$ 371.2
Gross Margin	**$ 71.4**	$ 51.1
EBITDA[1]	**$ 36.9**	$ 27.7

production services

Rents & leases natural gas compression processing equipment. Manages Variable Cost Production and Flue Gas programs primarily in Canada.

- Employs 1% of the staff
- Holds 21% of the assets
- Generates 5% of revenue
- Produces 27% of income before interest and income tax

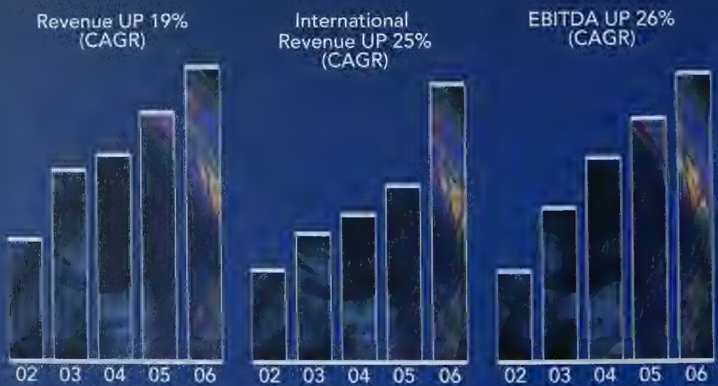
($ millions)	**2006**	2005
Revenue	**$ 36.0**	$ 31.4
Gross Margin	**$ 21.4**	$ 20.2
EBITDA[1]	**$ 29.4**	$ 27.1

[1] Earnings before interest, taxes, depreciation and amortization ("EBITDA") is a non-GAAP earnings measure that does not have a standardized meaning prescribed by GAAP and therefore is unlikely to be comparable to similar measures presented by other issuers.

a message to

5 Year Compounded Annual Growth Rate

($ millions)



our unitholders

dear fellow unitholders

Enerflex enjoyed a strong year in 2006 with solid gains in key measurements of performance. More importantly, our results reflect consistent growth over the past five years and substantial progress in the execution of our strategic plan.

Since 2002:

- Revenue has grown at a compound annual growth rate of 19%
- International revenue has tripled over this period from $92 million to $279 million, an annual compounded growth rate of 25%
- Earnings before interest, taxes, depreciation, and amortization (EBITDA) have increased at an annual compounded rate of 26%*
- Return on capital employed (ROCE) has increased from 6.9% to 16.1%*

*Net of one time trust conversion costs incurred in 2006.

The strong growth in international revenue, which has accelerated dramatically over the past two years, demonstrates that we are effectively executing our strategy of evolving into a globally focused provider of a wide range of value-added technologies and services.

Strategic Goals

- To achieve worldwide recognition as a premium provider of complete product and service solutions between the wellhead and the pipeline.
- Continue to deliver strong, consistent growth in revenues and profits by offering our customers the ability to cost effectively outsource their non-core activities.
- Develop technologies that clearly differentiate Enerflex in the worldwide market.

Domestic Market:

Our aim is to be recognized as far more than a leading provider of gas compression systems. Over the past two years we have developed our Variable Cost Production (VCP) initiative which involves Enerflex providing complete production, process and compression systems on a fee for throughput basis.

Today, we have the proven in-house capability to manufacture, install, maintain and operate complete production facilities. This offering provides significant benefits to producers in terms of return on capital, optimization of legacy assets and allowing greater focus on their core competency of finding and developing hydrocarbon reserves.

We are pleased with the progress of VCP which continues to make headway in gaining market acceptance. VCP will continue to grow, becoming a significant contributor of stable cash flow and profitability.

In addition, we are pursuing the field application of Flue Gas technology which involves capturing and compressing the exhaust gas stream from natural gas engines. Primarily used for under-balanced drilling and reservoir stimulation, this process has significant environmental and cost benefits. Field tests are ongoing with favourable initial results.

International Market:

There are three key components to our international strategy:

- Enerflex Global which provides international customers with a single point of contact, taking responsibility for the design and execution of projects up to $100 million in size.

- Regionalization, which establishes infrastructure and decision making capability within key market Regions around the world. This results in faster response to customer needs and a far better understanding of local market conditions and opportunities.
- The export of systems manufactured by Enerflex in Canada to support Enerflex Global and Regional activities.

2006 saw substantial progress on all three fronts as Enerflex Global was instrumental in the establishment of an engineering office in Kuala Lumpur, Malaysia and the successful completion of the $40 million El Wastani project in Egypt. AustralAsia, our largest International Region and the blueprint for future expansion of this concept, contributed approximately $154 million in revenue, including exports, an increase of 139% over 2005. Export shipments increased by 24% in 2006 over the prior year.

Market Conditions

The Canadian market is experiencing a moderation in demand for new equipment partly as a result of the decline in natural gas prices throughout the latter half of 2006. This has resulted in a slowing of new domestic order bookings for our Engineered Systems segment while both our Service and Production Services segments are maintaining their strong utilization and momentum.

We have been rewarded by our international strategy and investment. Markets outside Canada remain strong with new export orders and contracts from foreign countries increasing significantly in recent months to largely offset the tempering of domestic demand.

Trust Conversion:

On September 27, 2006, Enerflex Systems Ltd. received 99.9% shareholder approval to convert to an income trust which was subsequently finalized on October 2, 2006. This in turn resulted in the Company being renamed 'Enerflex Systems Income Fund' and on October 5, 2006, Enerflex Systems Income Fund units began trading on the TSX under the new symbol EFX.UN. Concurrently, a two for one unit split was completed.

On October 31, 2006, the Government of Canada unexpectedly announced a proposed tax on the distributions of income trusts. While final details of the legislation are not currently available, it is expected that there will be a four year grace period for trust conversions completed prior to October 31st, 2006. This four year period will provide ample time to determine an appropriate equity and balance sheet structure for Enerflex while allowing substantial tax savings to our equity holders during the interim period. The proposed legislation will not curtail our ability to grow.

Subsequent Event

On January 30, 2007, Enerflex purchased the assets of Powertec Beheer B.V. based in the Netherlands. This acquisition adds manufacturing expertise, strong gas engine aftermarket capability and a significant base of long-term service contract revenue to our existing European operations.

Integration is well under way and will result in Enerflex Europe having the size and critical mass to become our European Region, consistent with our Enerflex Global strategy.

In Conclusion

None of our success would be possible without the dedication and commitment of our employees. We would like to express our sincere thanks and appreciation to each of them for their commitment to integrity, safety and business performance. We would also like to thank our Board of Directors for their vision, guidance and commitment to strong corporate governance.

Finally, we would like to thank our unitholders for their support over the past year as we work hard to build Enerflex into a true world leader in our industry.

Sincerely,

J. Blair Goertzen
President and
Chief Executive Officer

P. John Aldred
Executive Chairman

business segments

service

Our Mechanical Service Division delivers field maintenance service, equipment and parts to the global oil and gas industry. This division specializes in equipment diagnostics, performance optimization, field maintenance and repair and troubleshooting for all major brands of gas compression, power generation and co-generation equipment.

During the year, Enerflex entered into a distribution and sales agreement for Canada with Altronic Inc., a leading manufacturer of ignition and control systems. The distributorship further establishes this division as a leading provider of top quality parts and services.

Continued strong international and domestic market demand will drive this division forward over the coming year. New product lines and expansion of current product lines, together with superior service, all contribute towards steadily improving results. The Service division will continue to play a key role in our Variable Cost Production initiatives.

The recent acquisition of the assests of Powertec in the Netherlands has substantially increased our footprint and critical mass in that Region. With proforma 2006 revenues of approximately $80 million, we have established our second international Region outside of North America. Powertec adds power systems manufacturing and Combined Heat and Power expertise, strong gas engine aftermarket capability and a significant base of long-term service contract revenue to our existing European operations.

Our Electrical Instrumentation and Controls Division ("EI&C") is one of the largest open shop electrical and instrumentation contractors in western Canada. They provide a comprehensive range of technologies, products and service to industries worldwide. From design to start-up assistance, round-the-clock service, maintenance and system upgrading, this division provides total electrical, instrumentation and controls solutions anywhere in the world. This division has also been recognized as a Safety Leader by the Governments of Alberta and Saskatchewan for its outstanding safety record and initiatives.

By maintaining their focus on customer relationships, developing new offerings, optimizing inventory levels and improving internal processes. EI&C is well positioned for continued growth in 2007.

engineered systems

Our Compression and Power Division is a world-class packager of natural gas compression and power generation systems. It offers a wide range of horsepower (50 – 6,000 hp) reciprocating or screw compression, standard or custom designs, new or reconditioned units for both onshore or offshore applications.

2006 saw continued success for this division as a number of new multiple unit orders were booked for both screw and reciprocating machines. A focus on improved plant utilization, modest price increases and lower overhead requirements will represent success factors for this division. These efforts will continue into 2007 and beyond.

Internationally, we expect this division to accelerate its efforts in designing and manufacturing specialized custom equipment for export to support increased international growth.

Our Production and Processing Division provides engineering, manufacturing, transportation, project management, and commissioning services for process plants.

This division made progress in the Canadian heavy oil sector through its steam-assisted gravity drainage (SAGD) water recovery modules. This technology is aimed at minimizing water disposal requirements reducing the environmental impact associated with traditional water disposal methods.

In 2006, Production and Processing increased its capabilities to meet increased demand for its products by building on its acquisition of HPS Group. The completion of the turnkey natural gas processing plant in Egypt and modest price increases contributed to its solid results.

With a record number of international bids outstanding and our expertise with respect to the development of northern Alberta's oil sands production, this segment is well positioned to benefit in the latter half of 2007.

production services

Our Production Services Segment offers the energy industry a wide range of options to produce and process natural gas without committing capital. Innovative offerings to acquire gas compression and production equipment include conventional rental as well as operating and finance leases. With the expertise of all of Enerflex's Engineered Systems business units, and its 40% equity investment in Total Production Services Inc., this division can install, own, operate, maintain and remotely monitor its equipment on a contract basis.

During the year, Production Services added to its rental fleet through the acquisition of Onstream Compressor Rentals Inc. This added 9 trailer mounted compression units to its fleet, making Production Services the second largest provider of rental equipment and the leading provider of large horsepower, trailer mounted rental equipment in Western Canada.

Positive 2006 results for this division were primarily a result of the availability of more compression equipment, Variable Cost Production and Flue Gas Recovery Technology.

Our goal of delivering domestic growth by offering customers cost effective outsource options is supported by the strong reception we are receiving from our Variable Cost Production initiative. We have the proven in-house capability to manufacture, install, maintain and operate complete production facilities. We optimize our customer's assets on a fee-for-throughput basis, aligning ourselves with their cash flow. Variable Cost Production deployed three new installations in 2006.

Enerflex has played a significant role in advancing the application of Flue Gas Recovery Technology by automating the process of delivering a virtually oxygen free, inert and neutral gas stream. This technology involves capturing and compressing the exhaust gas stream from natural gas engines. Primary uses are for under-balanced drilling and reservoir stimulation. This technology has significant positive environmental advantages over traditional nitrogen technology and is offered on a fee-for-throughput basis, similar to Variable Cost Production.

Production Services will continue to make solid gains in 2007 as growth in demand for its products increases and specific locations are targeted for growth in the United States and certain international markets.

health, safety

& our employees

our employees

Our employees are committed to finding innovative ways to perform their jobs responsibly. From minimizing risks on the job site to presenting cutting-edge, creative ways to lower operating costs, our employees share ownership and take responsibility.

Enerflex strives to reinforce a workplace culture where employees understand that employment security, conditions of employment and job satisfaction are interdependent with the need to generate profits and provide an adequate return to unitholders to ensure continuing investment in the business. Employees are regularly involved in risk assessments, process improvement initiatives, development of management plans and training. These initiatives actively encourage open lines of communication among the workforce and result in improvements to operational systems.

We would like to thank all our employees for their dedication, innovation, around-the-clock commitment to our operations and plain hard work. We will continue to encourage a culture of innovation and teamwork.

safety

We are very proud of our achievements in the area of safety. In October, our EI&C group reached a significant milestone with 2 million hours worked without a lost time incident. We have an unwavering, relentless commitment to excellence in this area that pervades everything we do. There is no job worth doing that doesn't bring all our employees safely home at the end of the day. Enerflex relies on all its employees to ensure that safe working practices are always put before performance.

Although we are very pleased with our safety results we are not satisfied. Our focus will remain on the ultimate goal of an entirely injury-free workplace. Experience has shown that high levels of performance are sustained only when safety is the first priority.

corporate governance

letter from the board of directors

The past year has provided a number of opportunities for Enerflex's Board of Directors to enhance our overall Corporate Governance platform. During 2006, we continued to build on the solid foundation we established in previous years. This foundation strengthened our core operations and ensured alignment of the interests of management and Board members with those of all stakeholders. This further solidified the vision, mission and values within our operations. Significant milestones reached in 2006 included improvement of internal controls over financial reporting and the establishment of a systematic approach for the oversight of significant transactions, such as the income trust conversion process and international acquisitions.

During 2006, requirements and implementation standards around internal controls over financial reporting continued to evolve. We pushed forward with our own program for completing the documentation and evaluation of disclosure controls, internal controls and controls over information and technology resources. This steadfast adherence to our established internal timetable has allowed us to position ourselves for international growth as well as compliance with legislation. Also during the year, the Toronto Stock Exchange Corporate Governance Guidelines were replaced by National Policy 58-101 F Corporate Governance Guidelines. The full disclosure of these guidelines, as they relate to Enerflex, has been included in our 2006 Information Circular. We are pleased to inform you that Enerflex is in full compliance.

In addition, we are pleased to report that previously established programs covering Board and Committee guidelines, disclosure practices, privacy laws and whistleblower communication programs have all operated in a manner consistent with their original purpose, which is to ensure that investors are protected through good governance and accountability.

Each of these measures ensures that your Board is in compliance with regulatory requirements and reinforces that we are committed to adopting emerging and best practices in Corporate Governance. The integrity of the Board is important for all stakeholders and we will uphold our responsibility by reviewing and amending our Charters annually.

On behalf of the Enerflex Board of Directors, we look forward to the continued success of your Company.

Sincerely,

Robert C. Williams
Lead Director

P. John Aldred
Executive Chairman

February 9, 2007

OUR VISION

We are a values-led team which will be recognized as the industry partner of choice by creating:

- A productive and safe work environment
- Employee pride
- Customer successes
- Vendor loyalty
- Sector-leading returns for shareholders

OUR MISSION

Through innovation, technical excellence and expertise, our team provides world-class products and services to the global energy sector.

OUR CORE VALUES

INTEGRITY...
"Do the right thing"

- Be honest
- Be fair
- Be trustworthy
- Be respectful
- Be ethical

COMMITMENT...
"Deliver on promises"

- Establish common goals and measure results
- Be safe
- Pursue excellence
- Understand customer needs, exceed expectations
- Be persistent

CREATIVITY...
"Lead with innovation"

- Value and reward creative thinking
- Explore new ideas
- Implement positive change
- Be bold

SUCCESS...
"Achieve sector-leading results"

- Optimize growth and financial performance
- Champion training, development and opportunity
- Communicate effectively
- Develop sustained, loyal relationships with all stakeholders
- Recognize and celebrate achievement

the ENERFLEX board

P. John Aldred

Patrick D. Daniel

J. Blair Goertzen

Douglas J. Haughey

P. John Aldred is the Company's Executive Chairman. During 2006 he relinquished the role of President and Chief Executive Officer of the Company. Mr. Aldred is the Chairman and Founder of the Cadmus Foundation, a member of the board of directors for Careers: The Next Generation and is a past member of Alberta Junior Achievement. Mr. Aldred currently serves as a public member and Vice-Chair of SAIT's Board of Governors and a member of its Audit Committee.

Patrick D. Daniel has been President and Chief Executive Officer of Enbridge Inc. since January 2001 and a director since May 2000. He is also a director of several Enbridge subsidiary companies and has over 35 years of experience in the energy industry. Mr. Daniel is a director of EnCana Corporation and Synenco Energy Inc. Mr. Daniel earned his Bachelor of Science degree from the University of Alberta and his Masters of Science degree from the University of British Columbia, both in Chemical Engineering. He is also a graduate of the Harvard Advanced Management Program.

Corporate Governance Committee

J. Blair Goertzen is the President and Chief Executive Officer at Enerflex, a position which he has held since June, 2006. Mr. Goertzen joined Enerflex in August 2003 as Executive Vice-President and Chief Operating Officer and in April 2005, assumed the role of President and Chief Operating Officer. From September 1999 to May 2003 Mr. Goertzen was President of IPEC Ltd., and through acquisition, assumed the role of Executive Vice-President of Flint Energy Services. From 1989 to 1999 Mr. Goertzen served as Vice President, Enserv Corporation, a company acquired by Precision Drilling, and subsequently assumed the role of Senior Vice President, Precision Drilling Corporation.

Douglas J. Haughey is the President of Spectra Energy Transmission West, responsible for its gas pipeline and processing business in western Canada. Mr. Haughey is also President and CEO of Spectra Energy Income Fund, serving as a director of various Spectra Energy subsidiary companies, Saskferco Products Inc. and certain industry and not-for-profit organizations. Mr. Haughey graduated from the University of Regina with a Bachelor of Administration degree in 1977, received his MBA from the University of Calgary in 1982 and his ICD.D designation from the Institute of Corporate Directors in 2007. Mr. Haughey has been an independent member of the Board of Directors since 2002.

Human Resources and Compensation Committee.

Robert B. Hodgins is an investor and corporate director. From 2002 to 2004, Mr. Hodgins served as the Chief Financial Officer at Pengrowth Energy Trust. Prior to this, Mr. Hodgins was Vice President and Treasurer of Canadian Pacific Limited and Chief Financial Officer of TransCanada Pipelines Limited from 1993 to 1998 and held various other positions at TransCanada commencing in 1981. Mr. Hodgins holds a Bachelor of Arts in Business from the Richard Ivey School of Business and is a Chartered Accountant.

Chair of the Audit Committee. Mr. Hodgins also chaired the Special Committee that evaluated the decision to convert the Company into an Income Trust.

f directors


Robert B. Hodgins


Geoffrey F. Hyland


Nancy M. Laird


J. Nicholas Ross


Robert C. Williams

Geoffrey F. Hyland is the former President and Chief Executive Officer of ShawCor. Mr. Hyland retired from ShawCor in 2005 after a 37 year career with the Company however, he continues to serve as a consultant and as a director of the company. Mr. Hyland is also a member of the board of directors for Fortis Inc., Exco Technologies Ltd. and SCITI Total Return Trust. Mr. Hyland holds an Engineering degree from McGill and an MBA from York University. Mr. Hyland has been an independent member of the Board of Directors since 1998.

Audit Committee; Corporate Governance Committee and Special Committee.

Nancy M. Laird is a Corporate Director with more than 20 years of experience in the energy industry. Ms. Laird served as a Senior Vice-President, Marketing and Midstream for PanCanadian Energy from 1997 to 2002. Prior to joining PanCanadian, Ms. Laird was President of NrG Information Services Inc., a joint venture initiative involving four of North America's leading natural gas pipeline companies with a mandate to create a seamless flow of natural gas across North America. Ms. Laird holds a Bachelor of Arts Degree (Honors) from the University of Western Ontario and earned her MBA from the Schulich School of Business at York University in Toronto.

Audit Committee; Special Committee and Chair of the Human Resources and Compensation Committee.

J. Nicholas Ross is the founder and Chairman, President and Chief Executive Officer of Rover Capital Corporation, a private merchant banking organization since 1996. From 1970 to 1996, Mr. Ross was a partner of Ernst & Young where he specialized in advising entrepreneurial businesses. From 1997 to 2004, Mr. Ross also served as a Trustee of Atlas Cold Storage Income Trust formerly ACS Freezers Income Trust and was a Chairman of its subsidiary, Atlas Cold Storage Holdings Inc. He was also a director of Scotia Split Corp and ED Smith & Sons Limited. His current directorships include two SCITI Trusts (Toronto), SCITI ROCS (Toronto), Canadian Resources Income Trust (Toronto) and Butterfield & Company in Bermuda. Mr. Ross holds a Bachelor of Arts with Honours in English Language and Literature from the University of Toronto and a Master in Arts in Economics from Cambridge University. He is a Chartered Accountant having earned the Ontario Gold Medal and Canadian Silver Medal on obtaining such designation in 1964. Mr. Ross has been an independent member of the Board of Directors since the founding of Enerflex in 1980. Mr. Ross is a member of the Audit Committee and was Chair of the Human Resources and Compensation Committee to December 31, 2006 and is still a member of that committee.

Audit Committee; Human Resources and Compensation Committee.

Robert C. Williams is Vice Chairman Equity Capital Markets and Syndication at Scotia Capital Inc. He has spent his entire business career of 39 years with Scotia Capital (formerly McLeod, Young & Weir & Co.). Mr. Williams is on the Board of Scotia Merchant Bank and a number of special purpose TSX listed companies that have been sponsored by Scotia Capital. He is also Chairman of the St. Andrew's College Foundation and is a member of that school's Board of Governors. Mr. Williams has been an independent member of the Board of Directors since the founding of Enerflex in 1980.

Chair of the Corporate Governance Committee and is the Lead Director.

governance overview

Enerflex's Board of Directors is made up of nine members, seven of whom are considered independent. These nine members bring to Enerflex a variety of skills and experience that help the Fund to realize its full potential and, the Board as a whole, to exercise its important corporate and legal responsibilities.

The Board is charged with the overall stewardship of the Fund. It is the authoritative body entrusted to oversee the management and the strategic direction of the Fund. In order to ensure the full accountability of the Board and Fund, three Committees have been delegated various oversight responsibilities: the Audit Committee, the Corporate Governance Committee and the Human Resources and Compensation Committee.

Mandate

The mandate of the Board of Directors of Enerflex is the stewardship of the business and affairs of the Fund on behalf of unitholders.

The Board seeks to discharge this responsibility by reviewing, discussing and approving the Fund's strategic planning and organizational structure and by encouraging Fund management to develop and enact a strategic plan and an organizational structure that enhance and preserve the business of the Fund and its underlying value. In broad terms, the stewardship of the Fund requires the Board to oversee the Fund's processes, practices and decisions with respect to strategic planning, risk management and mitigation, senior management appointments, communication planning, safety and environment, and internal control integrity.

attendance

	Board Meetings	Audit Committee	Human Resources and Compensation Committee	Corporate Governance Committee	Special Committee
P. John Aldred	10 of 10				
Patrick D. Daniel	10 of 10	4 of 4		3 of 3	
J. Blair Goertzen[1]	6 of 6				
Douglas J. Haughey	10 of 10		7 of 7		
Robert B. Hodgins	10 of 10	4 of 4			4 of 4
Geoffrey F. Hyland	10 of 10			3 of 3	4 of 4
Nancy M. Laird	10 of 10	4 of 4	7 of 7		4 of 4
J. Nicholas Ross	10 of 10	4 of 4	7 of 7		
Robert C. Williams	10 of 10			3 of 3	

Mr. Goertzen was appointed to the Board of Directors in June 2006.

committees

Enerflex's Board of Directors has appointed three committees with mandates and responsibilities as follows:

Audit Committee

The Audit Committee is established to fulfill applicable public company obligations respecting audit committees and to assist the Board in fulfilling its oversight responsibilities with respect to financial reporting including responsibility to:

- oversee the integrity of the Fund's financial statements and financial reporting process, including the audit processes;
- oversee the process through which management designs, implements and maintains the Fund's internal accounting controls, disclosure controls and the Fund's procedures and compliance with related legal and regulatory requirements;
- monitor the management of the principal financial risks that could impact the financial reporting of the Fund and ensure an appropriate mitigation strategy is adopted by management;
- oversee the appointment, qualifications and independence of the external auditors;
- oversee the work of the Fund's financial management, internal auditors and external auditors in these areas; and
- provide an open avenue of communication between the external auditors, the Board and Management.

Members: Robert B. Hodgins (Chair), Geoffrey F. Hyland, Nancy M. Laird, J. Nicholas Ross

Special Committee

The Board of Directors of Enerflex established a special committee to consider the possibility of reorganizing Enerflex into an income trust. Following deliberations and consultations with financial, legal and tax advisors, the Special Committee unanimously recommended to the Board of Directors that Enerflex proceed with the reorganization into an income trust.

Members: Robert B. Hodgins (Chair), Geoffrey F. Hyland, Nancy M. Laird

Corporate Governance Committee

The Corporate Governance Committee is responsible for overseeing and assessing the functioning of the Board, its committees and its members. The Committee oversees the development, implementation and assessment of effective corporate governance principles and guidelines. The Committee's responsibilities also include identifying candidates for director and recommending qualified director candidates for election at the next annual meeting of shareholders.

Members: Robert C. Williams (Chair), Patrick D. Daniel, Geoffrey F. Hyland

Human Resources and Compensation Committee

The Human Resources and Compensation Committee assists the Board in discharging its oversight responsibilities relating to the compensation and retention of key senior management employees, and in particular the Chief Executive Officer, with the skills and expertise needed to enable the Fund to achieve its goals and strategies at fair and competitive compensation and appropriate performance incentives. In addition, the Committee is responsible for producing an annual report on executive compensation for inclusion in the Fund's annual proxy circular in accordance with applicable securities laws.

Members: Nancy M. Laird (Chair), J. Nicholas Ross, Douglas J. Haughey

Evaluation

The Board of Directors shall review and reassess the adequacy of its mandate and each Committee shall evaluate its Charter at least annually and otherwise as it deems appropriate, and recommend any changes that it deems necessary. The performance of the Board of Directors in its entirety, of each Committee and of each individual board member shall be evaluated on an annual basis.

management's

The Management's Discussion and Analysis ("MD&A") should be read in conjunction with the audited consolidated financial statements for the years ended December 31, 2006 and 2005 and the accompanying notes to the consolidated financial statements contained on pages 58 to 87 of this annual report. The results reported herein have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP") and are presented in Canadian dollars unless otherwise stated. The MD&A has been prepared taking into consideration information that is available up to February 28, 2007 and focuses on key statistics from the consolidated financial statements, and pertains to known risks and uncertainties relating to the oil and gas service sector. This discussion should not be considered all-inclusive, as it excludes changes that may occur in general economic, political and environmental conditions. Additionally, other elements may or may not occur which could affect industry conditions and/or Enerflex Systems Income Fund ("the Fund") in the future. The MD&A should be read in conjunction with the remainder of the 2006 Annual Report. Additional information relating to the Fund, including the Fund's Annual Information Form, is available on SEDAR at www.sedar.com.

The annual report, which includes the MD&A, the audited consolidated financial statements and accompanying notes thereto, is reviewed and approved by the Fund's Audit Committee and its Board of Directors prior to publication.

On September 27, 2006, Enerflex Systems Ltd. ("the Company") held a Special Meeting of its Securityholders to consider a proposed reorganization of the Company pursuant to a Plan of Arrangement ("the Arrangement") under the Canada Business Corporations Act involving the Company, the Fund, Enerflex Systems Holdings Trust ("the Trust"), Enerflex Acquisition Ltd., Enerflex Holdings General Partner Ltd. ("the General Partner" or "Administrator") and Enerflex Holdings Limited Partnership ("the Partnership" or "LP"). The purpose of the proposed arrangement was to convert Enerflex Systems Ltd. from a corporate entity into a mutual fund trust which would distribute a substantial portion of its cash flow to the unitholders of the Fund. Pursuant to receiving shareholder approval and the approval of various legal and regulatory bodies, the conversion was completed on October 2, 2006. The reader is advised to refer to the Information Circular of Enerflex Systems Ltd. dated August 25, 2006 for further details.

The Fund, the Trust, the Partnership, the General Partner and the Company together with its subsidiaries and affiliates are collectively referred to as "Enerflex". Prior to the effective date of the conversion on October 2, 2006, the consolidated financial statements included the accounts of the Company, its subsidiaries, its equity interest in affiliates, and its 46.5% interest in the Presson Descon International (Private) Limited joint venture. The conversion to a trust has been accounted for on a continuity of interest basis and accordingly, the consolidated financial statements reflect the financial position, results of operations and cash flows as if the Fund had always carried on the business formerly carried on by the Company. Due to the conversion to a trust, certain information included in the consolidated financial statements for prior periods may not be directly comparable. For purposes of these financial statements, the share capital of the Fund is reported under Unitholder Capital (Note 9). Pursuant to the Arrangement, shareholders received either trust units, exchangeable LP units or a combination of trust units and exchangeable LP units of the Partnership for previously held shares of the Company. After giving effect to the Arrangement, the consolidated financial statements include the accounts of the Fund, its subsidiaries, affiliates, joint ventures and its partnerships.

discussion and analysis

The beneficiaries of the Fund are the holders of the Fund units and the partners of the Partnership who are the holders of exchangeable LP units. The quarterly distributions made by the Fund are determined by the Board of Directors of the General Partner. The Partnership earns interest income from a promissory note. The Partnership pays distributions to holders of exchangeable LP units in amounts equal to the distributions paid to the holders of Fund units. All distributions are made to unitholders of record on the last business day of each quarter.

Enerflex is a leading supplier of products and services to the global oil and natural gas production industry. Its core expertise lies in its ability to provide products and services to the industry segment that operates between the wellhead and the pipeline. Enerflex's primary products and services are: natural gas compression, power generation and process equipment for sale, rent or lease; hydrocarbon production and processing equipment and facilities; electrical, instrumentation and controls services; and a comprehensive package of field maintenance and contracting capabilities. Through its ability to provide these products and services in an integrated manner, or as stand-alone offerings, Enerflex believes it offers its global customers a unique value proposition.

Headquartered in Calgary, Canada, Enerflex has approximately 2,800 employees worldwide. The Fund, its subsidiaries, interests in affiliates and joint ventures, operate in Canada, Australia, the Netherlands, the United States, Germany, Pakistan, Egypt, Indonesia and Malaysia. The Fund's trust units trade on the Toronto Stock Exchange under the symbol "EFX.UN".

Forward-looking Statements

This MD&A contains forward-looking statements. Certain statements containing words such as "anticipate", "could", "expect", "seek", "may", "intend", "will", "believe" and similar expressions, statements that are based on current expectations and estimates about the markets in which the Fund operates and statements of the Fund's belief, intentions and expectations about development, results and events which will or may occur in the future constitute "forward-looking statements" and are based on certain assumptions and analysis made by the Fund and the General Partner derived from their experience and perceptions. All statements, other than statements of historical fact contained in this MD&A are forward-looking statements, including, without limitation: statements with respect to anticipated financial performance; future capital expenditures, including the amount and nature thereof; oil and gas prices and demand; other development trends of the oil and gas industry; business prospects and strategy; expansion and growth of the business and operations, including market share and position in the oilfield service markets; the ability to raise capital; non-resident ownership of the Fund; expectations regarding future distributions; expectations and implications of changes in government regulation, laws and income taxes; and other such matters. In addition, other written or oral statements which constitute forward-looking statements may be made from time to time by and on behalf of the Fund and the General Partner. Such forward-looking statements are subject to important risks, uncertainties, and assumptions which are difficult to predict and which may affect the Fund's and the General Partner's operations, including, without limitation: the impact of general economic conditions; industry conditions, including the adoption of new environmental, taxation and other laws and regulations and changes in how they are interpreted and enforced; volatility of oil

and gas prices; oil and gas product supply and demand; risks inherent in the ability to generate sufficient cash flow from operations to meet current and future obligations, including future distributions to unitholders of the Fund; increased competition; the lack of availability of qualified personnel or management; labour unrest; fluctuations in foreign exchange or interest rates; stock market volatility; opportunities available to or pursued by the Fund or the General Partner and other factors, many of which are beyond their control. As such, actual results, performance, or achievements could differ materially from those expressed in, or implied by, these forward-looking statements and accordingly, no assurance can be given that any of the events anticipated by the forward-looking statements will transpire or occur, or if any of them do so, what benefits, including the amount of proceeds, dividends or distributions the Fund and its unitholders, will derive there-from. The forward-looking statements contained herein are expressly qualified in their entirety by this cautionary statement. The forward-looking statements included in this MD&A are made as of the date of this MD&A and other than as required by law, the Fund and the General Partner disclaim any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Consolidated Results Of Operations

In 2006, Enerflex's strategy was to capitalize on solid activity levels in the Canadian oil and gas industry, further expand its international business and improve the operations of existing locations. In Canada, Enerflex took advantage of its strong product lines and brand recognition of its existing business units, developed new compression and production processing products, further expanded its rental fleet and introduced new service and product offerings. Internationally Enerflex approached its various markets in three manners. First, where the size and nature of the market warranted, Enerflex expanded or established business units offering mechanical services, equipment rentals, engineering support, and project management services. Second, Enerflex pursued projects ranging in size from $5 million to $100 million in regions where oilfield activity and natural gas infrastructure requirements presented opportunities for turnkey projects. Enerflex focused these efforts in Pakistan, Asia-Pacific and the Middle East. In these regions, Enerflex, individually or with partners, provided project engineering, facility construction, project management, and supervision and commissioning services for natural gas processing facilities requiring a combination of Enerflex's products. Third, in other markets, Enerflex positioned itself to expand the export sales of products manufactured in its North American based facilities.

By following this strategy Enerflex increased revenues by 18% to $792.3 million and maintained a solid gross margin of 22.1% while adapting to changing economic conditions and taxation laws, supply chain management concerns and the challenges of a strong labour market. In 2006 the Fund generated a return on capital employed of 14.0% and generated earnings of $0.89 per unit. Also during the year, Enerflex completed its conversion from a corporate structure into an income trust. This conversion, despite recent changes in the income tax treatment of income trusts in Canada, provides Enerflex the opportunity to substantially increase the cash distributions it makes to its unitholders. The total cost incurred to complete the conversion was $9.7 million. Excluding these one-time restructuring costs, Enerflex generated a return on capital employed of 16.1%, an EBITDA[1] of $96.4 million and generated earnings of $1.06 per unit. Net income, before the incurrence of trust conversion costs totalled $48.3 million an increase of $8.2 million or 20% on a comparative basis to 2005.

[1] Earnings before interest, taxes, depreciation and amortization ("EBITDA") is a non-GAAP (Generally Accepted Accounting Principles) earnings measure that does not have a standardized meaning prescribed by GAAP and therefore is unlikely to be comparable to similar measures presented by other issuers.

accomplishments

Specific accomplishments during the year include:

- The creation of Enerflex's first international region in AustralAsia with the consolidation of the management of business units within the region to focus on local opportunities. Revenues from this region, including exports, grew by 139% to $154.0 million in 2006;
- Increased international revenues by 58%, generating $175.0 million in revenue from international operations and $104.4 million from export product sales;
- Increased Electrical, Instrumentation and Controls ("EI&C") revenue by 6% and the division's earnings before interest and income taxes by 36%;
- Increased Production and Processing revenue by 78%;
- Expanded the compression rental fleet to 118,000 horsepower and completed the acquisition of Onstream Compressor Rentals Inc. ('Onstream") in October to become the leading provider of large horsepower, trailer mounted compression rental equipment in Western Canada;
- Commenced negotiations to acquire the business and assets of Powertec Beheer B.V. ("Powertec") in Europe. The successful completion of this acquisition on January 29, 2007 creates Enerflex's second international region with pro-forma revenues for 2006 of $80.2 million;
- Added three Variable Cost Production projects plus manufactured and successfully deployed two Flue Gas units;
- Increased the gross margin percentage in Compression and Power from 13.6% in 2005 to 16.1% in 2006; and
- During 2006 Enerflex accrued dividends and distributions to unitholders totaling $20.2 million as compared to dividend payments of $9.0 million in 2005, an increase of 124%. This equates to 35% of the estimated $57.8 million in distributable cash flow before trust reorganization costs for the year.

Economic Drivers

The energy service sector, of which Enerflex is a part, is largely dependent upon the spending levels and activities of crude oil and natural gas (hydrocarbon) exploration and production companies. These spending patterns vary dramatically year-over-year and from one global region to another and are influenced by many factors including: the current and expected commodity prices of crude oil and natural gas; the availability, access and cost of transporting hydrocarbon products; current and anticipated global supply and demand estimates; and a wide array of economic and political factors. As a result, the demand for oilfield products and services can be volatile and is impacted by factors that are outside the control and influence of oilfield service companies. In addition to fluctuating activity levels, access to skilled personnel, the supply and availability of major components and repair parts, and the competitive nature of the oilfield service sector are other challenges that face the industry sector and Enerflex.

During the past four years, the increases in oilfield activity and natural gas infrastructure development in Canada and other international markets has benefited Enerflex, primarily through increased demand for Enerflex's products and services, and improved facility and personnel utilization rates. Though international markets, and thus demand for Enerflex's products and services, continues to be strong, domestic demand for the Fund's Engineered Systems products has declined. In Canada, many natural gas producers reacted to the fluctuating commodity price, the increased drilling and finding costs, and recent changes in the income tax laws affecting income trusts by curtailing the drilling of new natural gas wells during the last half of 2006. This trend is expected to continue into 2007. Though the backlog of orders in the Compression and Power division as at December 31, 2006 is consistent with 2005, bookings of new orders for the Canadian market are expected to decline in 2007 as compared to 2006. As such, Enerflex is significantly increasing its international sales efforts to compensate for the anticipated reduction in Canadian orders. In Production and Processing the backlog of orders is lower at December 31, 2006 as compared to 2005, primarily as a result of the completion of international turnkey projects during the fourth quarter of 2006. Enerflex is aggressively pursuing additional international projects to replace these bookings in 2007. In addition to meeting the fluctuating demand for products and services, it has been necessary for Enerflex to maintain its competitive position and market share. This has been achieved by negotiating fair prices for Enerflex's products and services, expanding the global reach of Enerflex's export sales, developing and maintaining Enerflex's relationships with key customers and suppliers, maintaining the skill levels of Enerflex's people, and monitoring and adjusting to the practices of Enerflex's competitors. The ability to meet these competitive pressures within a reasonable cost structure will continue to be key to Enerflex's future success.

Summary Quarterly Statistics

The oil and natural gas service sector in Canada, where Enerflex's operations are currently concentrated, has a distinct seasonal trend in activity levels which results from well-site access and drilling pattern adjustments to take advantage of weather conditions. Generally, Enerflex's Engineered Systems segment experiences higher revenues in the fourth quarter of each year, its Service segment experiences higher revenues in the first quarter of each year and its Production Services segment experiences stable revenues throughout the year, impacted by both its customers' and the Fund's capital investment decisions. Variations from these trends usually occur when hydrocarbon energy fundamentals are either improving or deteriorating.

In 2006, revenues and earnings began to decline in the third and fourth quarter as compared to both the previous quarters in 2006 and the comparative quarters in 2005. This occurred as a consequence of reduced activity levels in the Canadian market, as previously discussed, increased operating costs associated with personnel, increases in the price of major components, and the $9.7 million in income trust reorganization costs.

Quarterly Summary

(Unaudited) (Thousands, except per unit/share amounts)	**2006** Q4	Q3	Q2	Q1	2005 Q4	Q3	Q2	Q1
Revenue	**$ 191,210**	**$ 194,210**	**$ 200,087**	**$ 206,823**	$ 203,108	$ 162,727	$ 157,088	$ 147,689
Gross margin	**38,985**	**44,600**	**45,131**	**46,554**	44,674	34,993	34,750	31,528
Gross margin %	**20.4%**	**23.0%**	**22.6%**	**22.5%**	22.0%	21.5%	22.1%	21.3%
Operating margin[1]	**11,427**	**18,146**	**19,993**	**21,576**	20,242	15,827	14,860	11,705
Operating margin %[1]	**6.0%**	**9.3%**	**10.0%**	**10.4%**	10.0%	9.7%	9.5%	7.9%
Net income	**$ 10,655**	**$ 4,719**	**$ 12,473**	**$ 12,904**	$ 13,714	$ 9,832	$ 9,164	$ 7,382
Per unit/share – basic	**$ 0.23**	**$ 0.11**	**$ 0.28**	**$ 0.29**	$ 0.31	$ 0.22	$ 0.21	$ 0.17
Per unit/share – diluted	**$ 0.23**	**$ 0.11**	**$ 0.27**	**$ 0.28**	$ 0.30	$ 0.22	$ 0.21	$ 0.17
Net income – adjusted[2]	**$ 10,881**	**$ 11,867**	**$ 12,680**	**$ 12,904**	$ 13,714	$ 9,832	$ 9,164	$ 7,382
Per unit/share – diluted – adjusted[2]	**$ 0.23**	**$ 0.26**	**$ 0.28**	**$ 0.28**	$ 0.30	$ 0.22	$ 0.21	$ 0.17
EBITDA[1]	**19,178**	**14,882**	**25,590**	**27,065**	25,140	20,743	19,277	16,235
EBITDA – adjusted[1]	**19,657**	**23,809**	**25,897**	**27,065**	25,140	20,743	19,277	16,235
Distributable cash flow[1]	**14,119**	**10,526**	**12,578**	**12,969**	16,561	10,945	9,763	5,600
Distributions/dividends	**11,669**	**2,842**	**2,839**	**2,832**	2,260	2,260	2,247	2,247
Distribution payout ratio	**83%**	**27%**	**23%**	**22%**	14%	21%	23%	40%
Distributable cash flow – adjusted[1]	**14,345**	**17,674**	**12,785**	**12,969**	16,561	10,945	9,763	5,600
Distribution payout ratio – adjusted[1]	**81%**	**16%**	**22%**	**22%**	14%	21%	23%	40%

[1] Operating margin, operating margin percent, earnings before interest, taxes, depreciation and amortization ("EBITDA"), distributable cash flow and distribution payout ratio are non-GAAP (Generally Accepted Accounting Principles) earnings measures that do not have a standardized meaning prescribed by GAAP and therefore are unlikely to be comparable to similar measures presented by other issuers. The Fund calculates these measures as follows:

Operating margin (Unaudited) (Thousands)	Three months ended December 31, 2006	Twelve months ended December 31, 2006
Gross margin	$ 38,985	$ 175,270
Selling, general and administrative expenses	27,621	105,680
Foreign currency losses (gains)	18	(1,484)
Equity earnings	(81)	(68)
Operating margin	$ 11,427	$ 71,142
Operating margin percent		
Operating margin divided by revenue (%)	6.0	9.0
EBITDA (Unaudited) (Thousands)		
Earnings before interest and income taxes	$ 13,320	$ 66,591
Depreciation and amortization	5,858	20,124
EBITDA	$ 19,178	$ 86,715
Reorganization costs	$ 479	$ 9,713
EBITDA-adjusted	$ 19,657	$ 96,428
Distributable cash flow (Unaudited) (Thousands)		
Cash flow from operations before changes in non-cash working capital	$ 14,890	$ 57,985
Maintenance capital expenditures	(771)	(7,793)
Distributable cash flow	$ 14,119	$ 50,192
Reorganization costs	226	7,581
Distributable cash flow-adjusted	14,345	57,773
Distribution payout ratio		
Distribution divided by distributable cash flow (%)	83	40
Distribution payout ratio-adjusted		
Distribution divided by adjusted distributable cash flow (%)	81	35

[2] Amounts have been adjusted to reflect the impact of the costs incurred by Enerflex for the conversion to an income trust which totaled $9,713,000 pre-tax and $7,581,000 after tax in 2006.

For The Three Months Ended December 31, 2006

During the fourth quarter of 2006 Enerflex generated $191.2 million in revenue, as compared to $203.1 million in the fourth quarter of 2005. The decrease of $11.9 million or 6% was a result of declining revenues in the Engineered Systems segment partially offset by increased revenue in both the Service and Production Services segments. As compared to the three month period ended December 31, 2005:

- Service revenue increased by $4.2 million as both Mechanical Service and EI&C activity remained strong and was generally not affected by lower commodity prices for natural gas;
- Production Services revenue increased by $2.5 million as a result of the acquisition of Onstream, the expansion of the rental fleet and Variable Cost Production contracts partially offset by lower rental fleet utilization rates; and
- Engineered Systems revenue declined. Increases in Production and Processing revenues of $8.5 million, resulting from international projects, were offset by a decline in Compression and Power revenue of $27.2 million. This decline in Compression and Power revenue resulted from the curtailment of Canadian drilling activity and a moderation in the demand for production equipment.

Gross margin for the three months ended December 31, 2006 was $39.0 million or 20.4% of revenue as compared to $44.7 million or 22.0% of revenue for the three months ended December 31, 2005, a decrease of $5.7 million. Each segment experienced a lower gross margin percentage than what was generated in the fourth quarter of 2005. Many factors contributed to this decline and are summarized as follows:

- Service gross margin percentage of 25.7% decreased from 28.6% in 2005 as the segment experienced higher labour and component costs and modest declines in labour utilization rates;
- Production Services gross margin percentage of 57.6% declined from 64.0% due to lower rental fleet utilization rates, increased depreciation charges and higher operating costs associated with the introduction and provision of Variable Cost Production and Flue Gas services; and
- Engineered Systems gross margin percentage of 13.0% decreased from 15.6% as a result of lower plant utilization rates due to reduced Canadian activity, price pressure in the low horsepower compression market and the accrual of international project commissioning costs. These costs have been expensed as the ultimate recovery of such costs is subject to further negotiation.

Selling, general and administrative ("SG&A") expenses were $27.6 million or 14.4% of revenue during the three months ended December 31, 2006, compared with $23.7 million or 11.6% of revenue in the same period of 2005. The $3.9 million increase in SG&A expenses during the quarter, as compared to the same period in 2005, is principally attributed to: the need to react to increased compensation pressures for skilled and professional employees; the Fund's growth initiatives in AustralAsia, the Middle East and Europe; and the amortization of assets acquired through various acquisitions. Specific cost increases occurred as follows: $1.4 million increase in personnel and compensation expenses; increased legal and financing costs of $0.8 million: increased depreciation of $0.4 million; increased bad debt expense of $0.4 million; higher amortization expense for intangible assets of $0.2 million; and increased office costs of $0.5 million.

Operating margin[1] assists the reader in understanding the net margin contributions made from the Fund's core businesses after considering all SG&A expenses, the impact of the Fund's foreign exchange hedging strategy and excluding reorganization costs. For the three months ended December 31, 2006, Enerflex produced an operating margin[1] of $11.4 million, or 6.0% of revenue, as compared to an operating margin[1] of $20.2 million, or 10.0% of revenue, for the same three month period in 2005. The reduction in operating margin[1] for the quarter as compared to 2005 occurred as a result of the same factors contributing to the reduced gross margin and increased SG&A expenses. The foreign exchange loss during the quarter resulted primarily from the Fund's hedging strategy and changes in the value of the Euro and United States dollar as compared to the Canadian dollar during the period.

Income before interest and income taxes totalled $13.3 million for the fourth quarter of 2006, as compared to $20.8 million for the same period in 2005. Income taxes for the quarter were reduced to $0.4 million from $5.6 million in the fourth quarter of 2005 as a consequence of the conversion to an income trust.

During the fourth quarter of 2006, Enerflex generated a net income of $10.7 million as compared to $13.7 million in the same period of 2005. This results in an earnings per income trust unit of $0.23 in 2006, as compared to $0.31 in the fourth quarter of 2005, adjusted for the two for one split which occurred on October 2, 2006.

During the quarter the Fund declared distributions of $0.25 per unit or $11.7 million. Including dividends previously paid in 2006, annual payments to unitholders totalled $20.2 million or 40% of distributable cash flow. The high payout ratio during the fourth quarter of 2006 was a result of the timing of maintenance capital spending and costs associated with the conversion to an income trust.

[1] Operating margin, operating margin percent and EBITDA are non-GAAP earnings measures that do not have a standardized meaning prescribed by GAAP and therefore are unlikely to be comparable to similar measures presented by other issuers.

Summary of Annual Highlights

For the years ended December 31,

(Unaudited)

(Thousands of dollars, except percent and per unit amounts)	**2006**	2005	2004
Revenue	**$ 792,330**	$ 670,612	$ 557,077
Gross margin	**175,270**	145,945	125,210
Gross margin percent of revenue	**22.1%**	21.8%	22.5%
Selling, general and administrative	**105,680**	85,523	77,372
Selling, general and administrative percent of revenue	**13.3%**	12.8%	13.9%
Operating margin[1]	**71,142**	62,634	50,067
Operating margin[1] percent of revenue	**9.0%**	9.3%	9.0%
Earnings before interest and income taxes	**66,591**	65,256	53,051
Net income	**40,751**	40,092	32,059
EBITDA[1]	**86,715**	81,395	68,153
EBITDA – adjusted[4]	**96,428**	81,395	–
EBITDA[1] percent of revenue	**10.9%**	12.1%	12.2%
Net capital spending	**$ 25,491**	$ 14,783	$ 30,429
Earnings per unit (basic)	**$ 0.89**	$ 0.89	$ 0.72
Earnings per unit (diluted)	**$ 0.89**	$ 0.89	$ 0.72
Return on capital employed[2]	**14.0%**	15.8%	14.0%
Return on average equity[3]	**11.6%**	12.8%	11.2%
Dividends/distributions declared per unit	**$ 0.44**	$ 0.20	$ 0.20
Distributable cash flow[1]	**50,192**	42,869	37,392
Distribution payout ratio[1]	**40%**	21%	24%
Distributable cash flow – adjusted[4]	**57,773**	42,869	37,392
Distribution payout ratio – adjusted[4]	**35%**	21%	24%
Total assets	**619,174**	564,315	486,865
Total long-term liabilities	**$ 148,889**	$ 78,598	$ 63,191

Financial Position and Ratios

As at December 31,	**2006**	2005	2004
Working capital	**$ 200,009**	$ 112,150	$ 86,587
Working capital ratio	**3.06**	1.72	1.69
Total debt, net of cash	**$ 111,213**	$ 103,264	$ 80,049
Total net debt to total net debt plus equity ratio (%)	**23.0**	23.9	21.2
Total net debt to EBITDA[1]	**1.29**	1.27	1.17
Earnings before interest and income taxes to interest expense ratio	**9.08**	14.06	13.86

[1] Operating margin, operating margin percent, EBITDA, distributable cash flow and distribution payout ratio are non-GAAP earnings measures that do not have a standardized meaning prescribed by GAAP and therefore are unlikely to be comparable to similar measures presented by other issuers.

[2] Return on capital employed is a non-GAAP measure that does not have a standardized meaning prescribed by GAAP and therefore is unlikely to be comparable to similar measures presented by other issuers. Return on capital employed is calculated as pre-tax income plus interest expense divided by the simple average of capital employed at the beginning of the year and at the end of each quarter. Capital employed is the sum of unitholders' equity plus current and long-term bank indebtedness.

[3] Return on average equity is a non-GAAP measure that does not have a standardized meaning prescribed by GAAP and therefore is unlikely to be comparable to similar measures presented by other issuers. Return on average equity is calculated as net income divided by the simple average of unitholders' equity at the beginning and end of the year.

[4] Amounts have been adjusted to reflect the impact of the costs incurred by Enerflex for the conversion to an income trust.

Consolidated revenue for the year ended December 31, 2006 totalled $792.3 million, an increase of $121.7 million, or 18%, as compared to 2005 consolidated revenue of $670.6 million. The revenue growth in 2006 was generated in Enerflex's Engineered Systems segment, which increased revenue by $92.0 million, or 25%; the Service segment, which increased revenue by $25.1 million, or 9%; and the Production Services segment which increased revenue by $4.6 million, or 14%. Engineered Systems' international revenue increased by $99.0 million as a result of growth in the AustralAsia region, the completion of a turnkey gas plant in Egypt and higher export sales. This was partially offset by a decrease in Canadian revenue of $7.0 million due to declining demand for low horsepower compression. Service revenue increases were driven by strong customer demand for engine maintenance and overhaul services and an increase in the number of contracts awarded to Enerflex's Canadian based EI&C division. Production Services revenues increased as a result of Enerflex's acquisition of Onstream, additional investments in the rental fleet and Variable Cost Production, partially offset by lower equipment utilization rates.

Gross margin has increased to $175.3 million or 22.1% of revenue in 2006 as compared to $145.9 million or 21.8% of revenue in 2005. The increase in gross margin of $29.4 million, or 20%, resulted from increasing revenues of $121.7 million and improvements in the gross margin percentage in the Engineered Systems and Service segments partially offset by a lower gross margin percentage in the Production Services segment. Factors that positively affected Enerflex's gross margin were: modest increases in the price of Enerflex's products and services; improved utilization of Enerflex's Engineered Systems facilities; and increases in the revenue generated from Enerflex's rental fleet. Gross margin improvement continues to be a focus of management's attention as exhibited by the improvement in the gross margin percentage over recent years.

Selling, general and administrative expenses were $105.7 million in 2006, compared with $85.5 million in 2005 and $77.4 million in 2004. Total SG&A costs increased in 2006 over both 2005 and 2004 as a consequence of the continued growth of Enerflex, the expanding scope of its operations, increased regulatory and compliance obligations and higher variable costs. In 2006, SG&A amounted to 13.3% of revenue as compared to 12.8% in 2005 and 13.9% in 2004.

The increase in SG&A expense in 2006 of $20.2 million related to the expansion of Enerflex's global business and increases in the various administration costs. During 2006, Enerflex incurred a full year's SG&A expenditure for its acquisition of HPS which occurred in July of 2005 totaling $6.1 million, established an engineering and application center in Kuala Lumpur, Malaysia totaling $0.2 million, and initiated Enerflex Global, Enerflex's international turnkey project management group incurring $0.7 million.

In addition to the growth initiatives outlined above, SG&A was also impacted by cost increases attributed to: the need to react to increased compensation pressures for skilled and professional employees; costs associated with the investigation of acquisition opportunities; the incurrence of bad debts; increased professional services due to financing, regulatory and litigation matters; and the amortization of assets acquired through various acquisitions. Specific cost increases occurred as follows: compensation costs increased by $4.8 million; increased audit, contract and legal costs of $3.5 million; increased depreciation and amortization of $1.8 million; an additional $1.2 million in bad debts; an additional $0.8 million for office and information and technology expenses; a $0.7 million increase in stock based compensation expense; and additional marketing and travel costs of $0.5 million. These costs were partially offset by a $1.2 million decrease in regulation and compliance costs associated with Enerflex's project for implementing the requirements of Multilateral Instrument 52-109.

Reorganization costs of $9.7 million were incurred in association with the decision to convert Enerflex from a corporate structure into a mutual fund trust. Pursuant to receiving the appropriate approvals, the conversion was completed on October 2, 2006 and resulted in the acceleration of various stock based compensation expenses and the incurrence of various consulting, legal, advisory and regulatory fees. It is presently believed that this structure will benefit unitholders by permitting for larger distributions and lower income taxes over the next four years.

Foreign exchange gains totalled $ 1.5 million in 2006 and $2.2 million in both 2005 and 2004. Most international Engineered Systems work is quoted in U.S. dollars and in some cases, the Euro. As the U.S. dollar depreciates, Enerflex's Canadian dollar revenue falls. The U.S. dollar appreciated by a negligible amount in 2006 and depreciated by 3% against the Canadian dollar during 2005, and by 7% in 2004. The Euro appreciated by 11% in 2006 against the Canadian dollar, depreciated 15% during 2005, as compared to a negligible change in 2004.

In mid-2003, Enerflex instituted a program to mitigate the impact of exchange rate fluctuations by matching expected future U.S. dollar-denominated cash inflows with U.S. dollar liabilities, principally bank debt and accounts payable. For example, when Enerflex is awarded a U.S. $1 million contract, it converts an equivalent amount of its bank debt from Canadian to U.S. dollars. The debt is repaid when Enerflex receives payment from its customer. The result is that any gain or loss in margins resulting from exchange rate fluctuations is offset by gains or losses in U.S. dollar liabilities. At December 31, 2006, Enerflex's bank debt included U.S. $24.0 million of U.S. Base Rate and LIBOR loans, compared to U.S. $43.8 million as at December 31, 2005 and $29.6 million as at December 31, 2004.

Enerflex does not hedge its exposure to investments in foreign subsidiaries, which are largely self-sustaining. Exchange gains/losses on net investments in foreign subsidiaries are accumulated in unitholders' equity as a "cumulative translation adjustment". The cumulative translation adjustment debit decreased from $6.3 million at the end of 2005 to $1.9 million at the end of 2006. This change is the result of the increase of the Euro, Australian dollar and U.S. dollar against the Canadian dollar. The Australian dollar appreciated by 7% against the Canadian dollar during 2006, as compared to a decline of 9% in 2005 and 4% in 2004.

Operating margin[1] assists the reader in understanding the net margin contributions made from Enerflex's core businesses after considering all SG&A expenses, the impact of the foreign exchange hedging strategy discussed above and excluding reorganization costs. During 2006, Enerflex produced an operating margin[1] of $71.1 million or 9.0% of revenue as compared to $62.6 million or 9.3% of revenue, in 2005 and $50.1 million, or 9.0% of revenue in 2004.

Interest costs totalled $7.3 million in 2006, compared with $4.6 million in 2005, an increase of $2.7 million. Interest costs in 2006 were higher than those in 2005 as a result of debt incurred to finance the increased working capital needs of Enerflex and its acquisitions of Onstream and HPS. Enerflex's total borrowings averaged $99.4 million in 2005 as compared to an average of $124.6 million in 2006. Enerflex has benefited from continued low interest rates as its bank debt was subject to floating rates.

Income tax expense was $18.5 million in 2006 compared with $20.5 million in the prior year. The decrease in income tax expense is a result of the Fund's conversion to an income trust in October 2006. The effective rate of income tax in 2006 was 31.2%, compared to 33.9% in 2005.

Net income for 2006 increased to $40.8 million compared to $40.1 million in 2005.

[1] Operating margin, operating margin percent and EBITDA are non-GAAP earnings measures that do not have a standardized meaning prescribed by GAAP and therefore are unlikely to be comparable to similar measures presented by other issuers.

Cash flow from operations was $15.6 million in 2006, compared with $21.5 million in 2005. Cash generated funded $14.1 million of net additions to rental assets, $7.8 million of net additions to property, plant and equipment and dividends to shareholders of $10.8 million. Additional borrowings under Enerflex's credit facility funded the contingent consideration for the acquisition of HPS and the acquisition of Onstream. During the year, non-cash working capital from operations increased to $172.8 million as a result of a $28.4 million increase in inventory and a $3.2 million decrease in total accounts payable, partially offset by a $6.6 million decrease in accounts receivable. Inventories increased in order to insure Enerflex had access to sufficient quantities of major components and parts for items that experienced long re-order lead times.

As compared to December 31, 2005 working capital has increased by $87.8 million to $200.0 million. This increase occurred as Enerflex renegotiated its credit facilities and extended the term of its operating line and term debt thus increasing working capital by $56 million. Increases in inventory, offset by reductions in other working capital items, as described above, accounted for the remainder of the change during the period.

Segmented Results

Enerflex has three business segments: Service, Engineered Systems and Production Services, which operate as follows:

1. Service is comprised of two divisions:

- Syntech's electrical, instrumentation and controls ("EI&C") business in Canada; and
- Mechanical Service, with business units operating in Canada (Pamco Jiro Service), the Netherlands (Landré Ruhaak bv), Australia (Gas Drive Systems Pty Limited) and Indonesia (PT Gas Drive Systems Indonesia) and its interest in S&L Energie Projekte GmbH, a 51% owned joint venture in Germany.

2. Engineered Systems is comprised of two divisions:

- Compression and Power has five business units: EFX Compression located in Calgary, Alberta, providing custom and standard compression packages for both reciprocating and screw compressor applications above 800 horsepower; Power, which provides electrical generation equipment in the under 10 mega-watt market; EFX Compression USA in Odessa, Texas, packages specialty natural gas applications; Jiro Compression, located in Stettler, Alberta, focusing on lower horsepower (sub 800 hp) screw compressor products; and Compression Services, located in Calgary, Alberta, re-engineering and refurbishing legacy compression equipment; and
- Production and Processing has four business units: Presson's modular natural gas processing equipment manufacturing facility in Nisku, Alberta; Mactronic's waste gas systems which are designed and fabricated in Red Deer, Alberta; HPS Group Limited, located in Perth, Western Australia; the Fund's 46.5% interest in the Presson Descon International (Private) Limited ("PDIL") joint venture, operating in Pakistan; and the Fund's new subsidiary EFX Global KL Bnd provides engineering and application services to HPS from Kuala Lumpur, Malaysia.

3. Production Services:

- Provides compression, power generation and natural gas processing equipment rentals, primarily in Canada. This division also supplies Enerflex's newest service offerings of Variable Cost Production and Flue Gas Compression.

Service

The Service business segment provides a complete line of mechanical and electrical, instrumentation and controls services to the oil and gas industry through an extensive branch network in Canada, Germany, the Netherlands, Australia and Indonesia. Service is Enerflex's second largest business segment. It employs 46% of staff, holds 31% of the total assets, generates 37% of Enerflex's revenue and produces 35% of Enerflex's income before interest and income taxes prior to trust reorganization costs. Key performance metrics include labour utilization, revenue, gross margin percent and income before interest and income taxes.

Enerflex, through various business units, is an authorized distributor for Waukesha engines and parts in Canada, Australia, Indonesia, Papua New Guinea, the Netherlands, Germany and Spain. Mechanical Service revenues tend to be fairly stable as ongoing equipment maintenance is generally required to preserve the customer's natural gas production. EI&C services are provided in Canada through Syntech where revenues are more cyclical as they are generated from both maintenance spending and from infrastructure investment. In 2005, Enerflex established a small presence in Poland to take greater advantage of the Waukesha distributorship awarded to it in this country and, due to insufficient returns, the decision was made to close this operation.

(Thousands) Years Ended December 31,	**2006**	2005
Service segment revenue	**$ 307,644**	$ 283,454
Intersegment revenue	**(14,477)**	(15,411)
Revenue	**$ 293,167**	$ 268,043
Gross margin	**$ 82,444**	$ 74,567
EBITDA[1]	**$ 30,138**	$ 26,632
Income before interest and income taxes	**$ 26,391**	$ 23,208

Service revenue was $293.2 million in 2006 and comprised 37% of consolidated revenue. This compares to $268.0 million and 40% of consolidated revenue in 2005. Mechanical Service generated 59% of the segment's revenue in 2006 and 58% in 2005. EI&C contributed 41% of the segment's revenue in 2006 and 42% in 2005. The increase in segment revenue of 9%, or $25.1 million, was a result of increased international revenue, higher demand for parts and services and strong oilfield service activity in Canada. Gross margin for the segment totalled $82.4 million, or 28.1% as compared to $74.6 million or 27.8% in 2005. The increase in gross margin percent was caused by increased parts sales and higher demand for Enerflex's services. In general, pricing increases were offset by increases in input costs, such as parts, materials, personnel costs and the costs associated with responding to supply chain management issues that arise in periods of high demand for these products. Income before interest and income taxes increased from 2005 by $3.2 million, or 14%, to $26.4 million as a result of these factors. The improvement in the profitability of the segment from 8.7% of revenue to 9.0% of revenue was due to the improved gross margin partially offset by higher branch and general administrative expenses.

[1] Earnings before interest, taxes, depreciation and amortization ("EBITDA") is a non-GAAP (Generally Accepted Accounting Principles) earnings measure that does not have a standardized meaning prescribed by GAAP and therefore is unlikely to be comparable to similar measures presented by other issuers.

Mechanical Service

Mechanical Service revenue for 2006 was $172.9 million, or 12% higher than 2005 revenue of $154.9 million. In Canada, which accounted for 69% of the division's revenue, as compared to 67% in 2005, sales increased by 14% over 2005 as a result of increased parts sales, increased customer demand for services and modest price increases. These were partially offset by lower utilization rates as the division increased its labour force to reduce the negative impacts of maintaining too high a utilization rate. During the fourth quarter of 2006, the division was granted a distributorship for Altronic, Inc. parts. Though this did not have a material impact on 2006 performance, it is anticipated to assist the division in growing its revenues and leveraging its cost base in the future.

International revenue increased by 6% over 2005. The increase in international revenue resulted from new maintenance contracts in Australia, increased service revenue in Europe and higher engine sales in Indonesia. International revenues were adversely impacted by the declining power generation market shares in the Waukesha product line. In order to better position the European and AustralAsia operations of this division, Enerflex acquired the assets of a competing service provider on January 29, 2007. This acquisition consolidates the European service market, provides Enerflex with greater access to an expanded customer base and expands the power packaging capabilities of Enerflex.

Gross margins for Mechanical Service increased by $4.9 million or 10% over 2005, though, as a percentage of revenue, the gross margin percentage was slightly lower at 30.8% as compared to 31.2% in 2005. Increased customer demand accounted for the increase in gross margin with the increase in costs of parts and personnel offsetting pricing increases resulting in the lower gross margin percentage. The division's income before interest and income taxes in 2006, increased by $1.3 million, or 7% as compared to 2005. As a percentage of revenue, income before interest and income taxes decreased to 11% from 12% due to the slight decrease in gross margin percentage and higher branch and general administrative expenses.

In 2007, in addition to leveraging the Altronic distributorship and integrating the recent acquisition, this division will seek ways to improve its efficiency and increase its net income before interest and income taxes through cost reduction, process improvement and revenue enhancement initiatives.

Electrical, Instrumentation and Control

The EI&C division continued to improve its gross margin as a percentage of revenue in 2006. During the year, EI&C generated revenue of $120.2 million, an increase of $7.1 million, or 6% as compared to $113.1 million in 2005. The EI&C business in Canada is highly competitive. Consequently, this division realizes lower margins than the Mechanical Service division and as such, it requires a focused and disciplined approach to the bidding and execution of the services provided. In 2006, the division focused its efforts on obtaining projects with higher margin potential and improving its gross margin percentage and reducing, as a percentage of revenue, the cost of maintaining its central services and branch infrastructure requirements throughout Alberta, Saskatchewan and northeast British Columbia. In 2006, the division increased its gross margin by $3.0 million or 11% as compared to 2005. As a percentage of revenue its gross margin increased from 23.2% in 2005 to 24.3% in 2006. The division's earnings before interest and income taxes increased by $1.9 million and were 36% higher in 2006 as compared to 2005. During the second quarter of 2006, the division was granted a distributorship for Texsteam Inc. parts. Though this did not have a material impact on 2006 performance it is anticipated to assist the division in growing its revenues and leveraging its cost base in the future.

In 2007, this division will continue to seek ways to improve its efficiency and increase its net income before interest and income taxes through cost reduction, process improvement and revenue enhancement initiatives, without reducing its margin potential.

Engineered Systems

The Engineered Systems business segment engineers, fabricates and assembles standard and custom-designed compression packages, production and processing equipment and facilities, and power generation systems. The key performance metrics for this business segment are market share, plant utilization, overhead application rates and gross margin as a percentage of revenue. Engineered Systems is Enerflex's largest business segment. It employs 53% of staff, holds 44% of the total assets, generates 58% of Enerflex's revenue and produces 38% of Enerflex's income before interest and income taxes prior to trust reorganization costs.

Engineered Systems' business tends to have more volatility in revenue, gross margin and income before interest and income taxes than Enerflex's other business segments. Revenues are derived primarily from the investments made in natural gas infrastructure by producers. Capital spending by Enerflex's customers was high in 2001, dropped sharply in 2002 and early 2003, increased in late 2003 and continued to grow from 2004 through to September 2006. As a result of softening natural gas commodity prices, increases in the cost of finding and developing hydrocarbon reserves and changes in income tax laws pertaining to income trusts, Canadian energy producing entities reduced the amount of capital they intend to invest during the latter half of 2006 and most of 2007. The international market continues to have favourable business conditions particularly in the AustralAsia region, the Middle East and Pakistan.

(Thousands) Years Ended December 31,	**2006**	2005
Engineered Systems segment revenue	**$ 500,459**	$ 393,703
Intersegment revenue	**(37,263)**	(22,551)
Revenue	**$ 463,196**	$ 371,152
Gross margin	**$ 71,391**	$ 51,143
EBITDA[1]	**$ 36,856**	$ 27,696
Income before interest and income taxes	**$ 29,301**	$ 22,460

Engineered Systems' revenue totalled $463.2 million in 2006 and comprised 58% of consolidated revenue. This compares to $371.2 million and 55% of consolidated revenue in 2005. Compression and Power generated 55% of the segment's revenue in 2006 and 68% in 2005. Production and Processing contributed 45% of the segment's revenue in 2006 and 32% in 2005. The increase of $92.0 million, or 25%, in segment revenue for the year was a result of the acquisition of HPS in 2005, the completion of the turnkey natural gas processing plant in Egypt and modest increases in the pricing of the segment's products. Gross margin for the segment totalled 15.4%, or $71.4 million, as compared to 13.8% in 2005. The increase in gross margin of $20.2 million, or 40%, was a result of the same factors that improved the segment's revenue. Income before interest and income taxes increased by $6.8 million, or 30%, to $29.3 million as a result of the above-mentioned factors.

[1] Earnings before interest, taxes, depreciation and amortization ("EBITDA") is a non-GAAP (Generally Accepted Accounting Principles) earnings measure that does not have a standardized meaning prescribed by GAAP and therefore is unlikely to be comparable to similar measures presented by other issuers.

Compression and Power

The Compression and Power division contributed revenue of $252.5 million, a decrease of $0.3 million over the prior year. International revenue in the division totalled $61.4 million in 2006, as compared to $49.8 million in 2005. Though revenues during the first nine months of 2006 increased over the first three quarters of 2005, softening energy prices, the perception of high drilling and completion costs and changing tax laws negatively impacted the spending patterns of energy producing entities in Canada. As such, order bookings declined in 2006 as compared to 2005. In anticipation of the slowing of domestic orders, Enerflex devoted a greater proportion of its sales efforts to international markets. This resulted in higher international order bookings in 2006 as compared to 2005. While definitive market share data is difficult to obtain, Enerflex estimates that its Canadian large horsepower compressor package market share was constant in 2006 as compared with 2005. Though pricing leverage was difficult to achieve in 2006, what has been gained during the year is presently under pressure as domestic competition for order bookings increases.

During 2006, gross margin increased by $6.4 million, or 19% as a result of improved plant utilization, modest pricing increases and lower overhead rates. These were partially offset by increased component, material and personnel related costs, obsolescence provisions and warranty costs. The division's gross margin totalled 16.1% of revenue in 2006 as compared to 13.6% in 2005. At present, Enerflex owns approximately 370,000 square feet of compression shop floor space in North America and during 2006 management estimates that the average utilization rate, based on the theoretical plant capacity in labour hours, was 71% as compared to 67% in 2005. The Compression and Power division's income before interest and income taxes increased by 30%, to $19.6 million as a result of the factors mentioned above.

In 2007, the division will focus its sales efforts on international order bookings, continue to execute on its existing order backlog and seek opportunities to reduce the impact of anticipated lower plant utilization rates. A continuing challenge to achieving improved profitability in 2007 will be the timely availability of certain OEM components and repair parts, and the access and availability of engineers and skilled trade personnel, both of which will be in steady demand given the strong employment conditions for such personnel.

Production and Processing

The Production and Processing division contributed revenue of $210.7 million, an increase of $92.4 million, or 78% over the prior year. While definitive market share data is difficult to obtain, Enerflex estimates that it has maintained its domestic and international market share, and through the acquisition of HPS in 2005, Enerflex has increased its market share in Australia. In each market segment competition remains strong. The increase in the division's revenues resulted from the inclusion of HPS for an additional six months, adding $47.6 million, and $27.8 million as a result of growing business prospects in AustralAsia and stronger demand for the business unit's environmental products. Infrastructure spending in the region, combined with the expansion of HPS into eastern Australia, and growth in the CBM market in the country have all contributed to the region's growth. Production and Processing revenues also increased by $10.5 million as a result of the completion of a turnkey natural gas processing plant in Egypt and $4.8 million from domestic markets. The continued awarding of future international turnkey projects and product sales will be crucial to the continued success of the division in 2007.

During 2006, gross margin increased by $13.9 million, or 82% as a result of the factors identified above. The division's gross margin totalled 14.6% of revenue in 2006 as compared to 14.3% in 2005. At present, Enerflex owns approximately 107,000 square feet of production and processing shop floor space in Alberta, Canada and 62,000 square feet of shop floor space in Perth, Western Australia. During 2006, management estimates that the average utilization rate, based on available labour hours, in its Canadian based facilities was 90% as compared to 92% in 2005 and 87% in its Australian based facilities as compared to 87% in 2005. The division's income before interest and income taxes increased by 31% during 2006 to $9.7 million, as compared to 2005.

In 2007, the division will continue to supply products to the domestic energy market and will pursue international projects in AustralAsia, Pakistan and the Middle East through various Enerflex business units.

Engineered Systems Segment Bookings

During 2006, Enerflex experienced a decrease in its order bookings in the Engineered Systems segment by approximately 13% versus bookings recorded in 2005. The Engineered Systems segment's order backlog at December 31, 2006 was approximately 24% below the segment's order backlog at December 31, 2005 principally as a result of the completion of production and processing international contracts. New international orders are presently being pursued.

Production Services

The Production Services business segment provides a variety of rental and leasing alternatives for natural gas compression, power generation and processing equipment. At the end of 2006, Enerflex's rental fleet was comprised of approximately 381 compression units and 118,000 horsepower and 167 processing units. This compared with 370 units and 104,000 horsepower and 152 processing units in 2005. The compression fleet averaged 368 units and 105,000 horsepower during 2006. The key performance metrics in this business are fleet size, utilization rates and rental rates. The Production Services segment employs 1% of staff, holds 21% of the total assets, generates 5% of Enerflex's revenue and produces 27% of Enerflex's income before interest and income taxes prior to trust reorganization costs.

Enerflex's rental fleet is located principally in western Canada. Expansion in international markets is presently being continued on a selective basis to minimize the risk from these new markets. As of December 31, 2006, Enerflex's compression rental fleet included 14 units located in the United States and 6 units in Australia.

(Thousands) Years Ended December 31,	**2006**	2005
Production Services segment revenue	**$ 35,988**	$ 31,563
Intersegment revenue	**(21)**	(146)
Revenue	**$ 35,967**	$ 31,417
Gross margin	**$ 21,435**	$ 20,235
EBITDA[1]	**$ 29,434**	$ 27,067
Income before interest and income taxes	**$ 20,612**	$ 19,588
Capital expenditures, net of proceeds on disposal	**$ 17,322**	$ 5,798

[1] Earnings before interest, taxes, depreciation and amortization ("EBITDA") is a non-GAAP (Generally Accepted Accounting Principles) earnings measure that does not have a standardized meaning prescribed by GAAP and therefore is unlikely to be comparable to similar measures presented by other issuers.

Revenue in 2006 increased by $4.6 million, or 14%, to $36.0 million. While the segment owns and rents compression, power and processing equipment, the main driver for its revenue growth is the rental of compression equipment and its Variable Cost Production ("VCP") offering. In 2006, the segment's revenue was generated 84% by compression, 9% by power and processing equipment and 7% by VCP. The revenue increase experienced in 2006 over 2005 was a result of the availability of more compression equipment, the introduction of variable cost processing and Flue Gas equipment rentals, and modest price increases. These were partially offset by lower utilization rates during the year. Overall, the segment experienced compression rental utilization rates, based on capital deployed, of 74.6% compared to 80.3% in 2005. Power and processing fleet utilization rates, based on average capital deployed, decreased from 67.7% in 2005 to 62.4% in 2006. The reduction in utilization rates was attributed to higher than anticipated energy prices resulting in higher cash flows and working capital in the hands of the segment's customers. Consequently, these customers tended to acquire compression assets, as exhibited through the revenues generated by the Compression and Power division, and to purchase compression assets previously under rental, also exhibited by the higher proceeds on the sale of rental assets. Gross margin for 2006 totalled $21.4 million, 59.6% of revenue, as compared to $20.2 million, 64.4% of revenue, in 2005. The reduction in gross margin as a percent of revenue was caused by product introduction and operating costs associated with new product offerings and lower equipment utilization rates.

During 2006, Production Services sold 33 compression units and 50 power and process equipment units from its fleet, for gross proceeds of $17.6 million and a gain on sale of $3.3 million. This compares to 40 compression units and 51 power and process equipment units, for gross proceeds of $17.7 million and a gain on sale of $2.5 million in 2005. The sale of units generally occurs when customers exercise their contractual option to purchase equipment. To satisfy the growing demand for rental equipment, Enerflex added 35 compression units and 65 power and processing units to its fleet in 2006, for an investment of $31.8 million. These capital expenditures are in addition to the acquisition of Onstream on October 9, 2006 for $5.9 million. This acquisition added 9 trailer mounted compression units to the segment's fleet and resulted in Enerflex becoming the dominant provider of trailer mounted compression packages in western Canada.

Production Services expects continued growth in demand for its products in Canada, and has targeted specific geographic regions for expansion in the United States and abroad. Production Services does not generally increase the capital invested in its fleet unless it has rental contracts. Growth in the rental fleet is expected to be the largest internal capital investment opportunity for the Fund in 2007. Though VCP comprised 7% of the segment's revenue, Enerflex committed approximately $5 million of its capital into this endeavor. Enerflex is pleased with the initial level of interest in this new offering and estimates that it could deploy $15 million in capital towards this initiative during 2007. VCP provides Enerflex the opportunity to combine the strength of its balance sheet with its expertise in compression optimization, maintenance and operations in order to improve the returns generated from existing compression and processing assets for both its customers and its unitholders.

Accounting practices in the oilfield rental business vary significantly from business to business. Key accounting policies followed by Enerflex's Production Services business are as follows:

- All equipment and related debt are recorded on the balance sheet. No equipment is in special purpose entities. There is no "off-balance sheet" debt;
- Rental equipment is depreciated over its useful life, which has been estimated to be approximately 15 years. Depreciation expense is recorded regardless of whether the equipment is in service or idle; and
- When, under the terms of a rental contract, Enerflex is responsible for maintenance and overhauls, the expense is accrued monthly to match maintenance expense with the related revenue. Maintenance and overhaul costs incurred are charged to the accrued maintenance liability and are not capitalized.

Financial Condition and Liquidity

As compared to December 31, 2005 working capital has increased by $87.8 million to $200.0 million. This increase occurred as the Fund renegotiated its credit facilities and extended the term of its operating line and term debt thus increasing working capital by $56.0 million. Increases in inventory, offset by reductions in other working capital items, as previously discussed, accounted for the remainder of the change during the period.

On February 28, 2007, the Fund had 46,677,408 income trust units and Exchangeable LP units outstanding. Enerflex has not established a formal distribution policy and its Board of Directors of the General Partner anticipates setting the quarterly distributions based on the availability of distributable cash flow and anticipated market conditions, taking into consideration business opportunities and the need for growth capital. In 2006, prior to the conversion, Enerflex declared quarterly dividends equal to $0.0625 per trust unit for a total of $0.1875 per trust unit for the first three quarters of 2006. Post conversion, the Fund declared a cash distribution of $0.25 payable on January 15, 2007.

During 2006, the Fund completed the restructuring of its debt with the closing of a private placement for $100.6 million Senior Secured Notes ("Notes") and the amendment of its bank credit facility ("Bank Facility") for $150.0 million. The Notes mature on two separate dates with $21.0 million maturing on December 20, 2013 and $79.6 million maturing on December 20, 2016. The Bank Facility matures June 30, 2009 and is extendible at the banks' option in June of each year.

The Notes and Bank Facility share security on a pari passu basis with collateral consisting of a fixed and floating charge on the Fund's Canadian assets and guarantees from various subsidiary companies. These credit facilities require the Fund to meet certain covenants, including a limitation on the debt-to-EBITDA[1] ratio and a limitation on distributions to unitholders in certain circumstances. Enerflex was in full compliance with these covenants at December 31, 2006 and February 28, 2007.

On February 28, 2007, $100.6 million Notes were outstanding and approximately $61.5 million of the $150.0 million Bank Facility was drawn, comprised of $45.6 million in cash borrowings and $15.9 million in letters of credit or guarantee, leaving approximately $88.5 million available for future drawings. These credit facilities provide the financing required to support the Fund's operating requirements, as well as the flexibility to pursue growth opportunities.

Subsequent Events

On January 30, 2007, Enerflex entered into an agreement with the shareholders of the Netherlands based Powertec Beheer B.V. ("Powertec"), whereby Enerflex acquired the operating assets of Powertec. Powertec adds power systems manufacturing and Combined Heat and Power expertise, strong gas engine aftermarket capability and a significant base of long-term service contract revenue to our existing European operations. This acquisition substantially increases Enerflex's critical mass and footprint in the region. Powertec has a core team of approximately 100 personnel headquartered in a 73,000 square foot manufacturing facility in Rijsenhout, the Netherlands. Powertec generated revenue of approximately $56 million in 2006. It is anticipated Powertec will be accretive to Enerflex's cash flow in 2007 as it generates gross margin and earnings consistent with Enerflex's existing European business.

[1] Earnings before interest, taxes, depreciation and amortization ("EBITDA") is a non-GAAP (Generally Accepted Accounting Principles) earnings measure that does not have a standardized meaning prescribed by GAAP and therefore is unlikely to be comparable to similar measures presented by other issuers.

Contractual Obligations and Committed Capital Investment

The Fund's contractual obligations are contained in the following table. Details of the amounts payable if the Bank Facility is not renewed are in Note 5 to the financial statements.

Contractual Obligations

(Thousands)

	Payments due by period				
Contractual obligations	Less than one year	2-3 years	4-5 years	Thereafter	Total
Leases	$ 9,206	13,420	3,490	213	$ 26,329
Purchase obligations	70,462	4,235	–	–	74,697
Total	$ 79,668	17,655	3,490	213	$ 101,026

The majority of Enerflex's lease commitments are operating leases for Service vehicles.

The majority of Enerflex's purchase commitments relate to major components for the Engineered Systems segment and to long-term information technology and communications contracts entered into in order to reduce the overall costs of services received.

In addition to the contractual obligations above, Enerflex has budgeted for capital spending investments of $44.7 million in 2007. Of that, $23.7 million relates to the expansion of Enerflex's rental fleet; $10.0 million in for Variable Cost Production opportunities; $2.2 million relates to business application software and information technology investments; and the balance is for normal replacement and expansion needs. As of February 28, 2007, a total of $18.6 million has been committed.

Critical Accounting Estimates

The Fund's significant accounting policies are described in Note 1 to the consolidated financial statements. The preparation of these statements requires the use of estimates and judgments that affect the reported revenues and expenses, assets, liabilities and unitholders' equity. These estimates and judgments are based on historical experience and various assumptions, which management believes to be reasonable in the circumstances. Future events cannot be anticipated with certainty and as such, these estimates and assumptions may change as additional evidence is gathered, new circumstances arise and as the Fund's operating environment changes.

The accounting estimates believed to be the most difficult to determine, or which depend on the most complex of judgments and which have the most impact on the Fund's results of operations and financial position are as follows:

Revenue Recognition

Enerflex's Engineered Systems segment applies the percentage of completion method of revenue recognition for determining periodic revenue allocations for projects in progress at each month end. In general, these contracts are completed within a period not exceeding six months. This methodology requires the use of estimates, based on the historical knowledge and experience of the Fund, the specific circumstances of the project and the anticipation of future events in order to determine various factors. These include the stage of project completion, future costs to be incurred in the completion of the project, timing of contract completion and delivery to the ultimate customer and an estimate of the ultimate gross margin to be earned. These estimates are continually evaluated and may change based upon significant or unanticipated changes in future events; the cost, availability and timing of delivery of materials or components; and the occurrence of unanticipated difficulties in the fabrication or shipping process. In addition to affecting the determination of revenue and gross margin, these estimates could also impact the need for provisions related to late delivery penalties on contracts subject to such conditions. At every month-end, Enerflex reviews each of the projects in progress and evaluates the reasonableness of each estimate made. Upon the completion of the project, a gross margin analysis is prepared to ensure that over the course of the project appropriate revenues and costs have been recorded.

Trust Unit Options and Other Unit-Based Compensation

Enerflex adopted the fair value method of accounting for trust unit options and phantom trust units. The determination of the unit-based compensation expense for trust unit options and phantom trust units requires the use of estimates and assumptions based on exercise prices, market conditions, vesting criteria, length of employment and past experiences of the Fund. Changes in these estimates and future events could alter the determination of the provision for such compensation. Details concerning the assumptions used are shown in the notes to the financial statements.

Allowance for Doubtful Accounts Receivable

Enerflex performs ongoing credit evaluations of its customers and grants credit based upon the customer's past payment history and financial condition, taking into consideration anticipated changes in industry, economic and political conditions. Customer payments are regularly monitored and a provision for doubtful accounts is established based upon specific situations. Enerflex's experience with respect to the incurrence of bad debt losses has been within expectations and has generally been limited to a select number of specific customer situations. However, given the cyclical nature of the global oil and natural gas services industry and the risk associated with finding and producing hydrocarbons, a customer's ability to fulfill its obligations can change without notice.

Excess and Obsolete Inventory Provisions

Enerflex regularly reviews the nature and quantities of inventory on hand and makes provisions for excess or obsolete inventory items based on historical usage patterns, known changes to equipment or processes and customer demand for specific products. Significant or unanticipated changes in business conditions could impact the magnitude and timing of the provisions for excess and obsolete inventory.

Warranty Provisions

Enerflex regularly reviews the nature, size and underlying cause of all warranty claims made by customers with respect to Enerflex's products and services and makes provisions for future warranty claims based on historical information, production patterns and known changes to equipment or processes. Significant or unanticipated changes in customer claim patterns, the quality of suppliers' delivered component parts, the availability of skilled personnel or unforeseen effects of changes in the processes adopted by Enerflex could impact the magnitude and timing of future warranty costs.

Rental Equipment Overhaul Expenditures

Enerflex regularly reviews the nature and cost of all major or minor equipment overhaul expenditures incurred with respect to its rental fleet of compressors, power generation and process equipment. As Enerflex is generally responsible for these costs under the terms of its rental agreements, it makes provisions for future equipment overhaul costs associated with the current rental revenues based on historical information, changes in equipment specifications and changes in operating conditions. Significant or unanticipated changes in the cost of such expenditures, operating environments, the availability of repair and maintenance parts, or the availability of skilled labour could impact the magnitude and timing of estimates related to overhaul expenditures.

Depreciation and Amortization

Enerflex's rental assets, and property, plant and equipment are depreciated and amortized based upon estimates of useful lives and salvage values. These estimates may change as more experience is gained, market conditions shift or as future production methodologies are adopted by Enerflex's customers.

Goodwill and Long-lived Assets

Goodwill and long-lived assets comprise a significant component of the Fund's asset base. The carrying values of these assets are reviewed at least annually for impairment or whenever events or changing circumstances indicate that their carrying value may not be recovered. This requires the Fund to forecast future cash flows to be derived from such assets based upon assumptions about a variety of future events. Significant unanticipated changes to these assumptions could materially alter the Fund's estimates of any provision for impairment made by the Fund in the future.

Income Taxes

The Fund uses the liability method for determining its income tax provisions and liabilities. This methodology takes into consideration the differences between financial statement treatment and income tax treatment of certain transactions, assets and liabilities. Current and future income tax assets and liabilities are recognized for the income tax consequences attributed to the Fund's current year operations and the differences between the financial statement treatment and income tax treatment of the matter. Valuation allowances are established to reduce future income tax assets when it is believed that a portion of the asset may not be realized. Estimates of future income tax rates, future income taxes payable and the continuation of prudent tax planning initiatives have been considered in making these valuation assessments. Changes in circumstances, assumptions and the clarification of uncertain taxation matters may require the valuation allowances to change.

Internal Controls

The implementation of Bill 198 by the Ontario legislature and similar legislation in other Canadian provinces as well as the implementation of Multilateral Instruments 52-109 and 52-110 and National Instruments 58-101 and 58-201 by the Canadian Securities Administrators, resulted in additional legal requirements for Corporate Governance. These instruments are the Canadian response to the Sarbanes-Oxley legislation in the U.S. Enerflex is committed to adopting emerging and best practices in Corporate Governance. The Fund believes that Corporate Governance is fundamental to an efficient and effectively operated organization, as it contributes to business and financial success.

In June 2003, Enerflex began developing its Value Improvement Program for Enhanced Results ("VIPER") program. This was designed to assist Enerflex in meeting the requirements of Bill 198 and the attendant securities regulations, and, where possible, to add unitholder value through improvements in processes throughout the Fund. This project was substantially complete at December 2006 and is now transitioning to sustainment within the organization and its business units.

In 2005, Enerflex completed the documentation and evaluated the effectiveness of its disclosure controls and procedures and has determined that it is compliant with the present requirements for such matters. During 2006 these controls were tested to ensure they continued to operate as designed. Furthermore, the Fund has completed the documentation and evaluation of the existing business processes and associated internal controls over financial reporting for all material business units. Remediation actions for control gaps identified were also implemented and Enerflex commenced internal testing of its key controls over financial reporting during the third quarter of 2006.

During 2006, in order to position the organization to be compliant with the requirements of Bill 198 and the attendant securities regulation, Enerflex amended its internal control environment in the following areas:

- Revised or created additional corporate governance documentation and materials as required by amendments to the Canadian Securities legislation;
- Added monitoring capabilities to assist in the evaluation of the Fund's compliance with the requirements of its corporate governance policies;
- Established an internal audit department and executed the 2006 internal audit program of internal control testing in all material business units;
- Continued to enhance the level of general controls over information technology resources including the implementation of a standardized approach to general information technology controls at all major Enerflex offices around the world;
- Continued the consolidation and optimization of information technology business applications across business units through the execution of the Fund's information technology strategic plan;
- Undertook various training initiatives aimed at improving the awareness of the added requirements, the Fund's corporate governance policies, its values and disclosure requirements; and
- Began the design and implementation of a long term sustainment program to maintain the quality of internal control documentation and standards for compliance and to preserve the integrity of the internal control system as designed.

During the fourth quarter of 2006, Enerflex amended its control environment to enhance the internal controls over revenue accrual procedures, inventory transfers and the segregation of incompatible functions. Information technology application controls were also amended to further restrict access to the ability of personnel to post transactions and amend master file data. These enhancements to internal control did not result in any adjustments to Enerflex's disclosures or its financial statements.

Since the inception of this project, Enerflex has incurred external consulting costs of approximately $4.6 million up to and including December 31, 2006.

Management has determined that it has designed a system of internal control over financial reporting and is in compliance with the prescribed legislation in effect at December 31, 2006.

Outlook For Markets and Competition

As a Canadian-based provider of equipment and services to the global oil and natural gas industry, Enerflex's business prospects are influenced by several market factors. These include the business outlook for oil and natural gas producers, prospects for natural gas infrastructure development, as well as the business outlook and competitive environment within the oil and natural gas service industry.

Industry Outlook – Oil and Gas Producers

While Enerflex continues to build its international presence, the Fund's fortunes are largely tied to natural gas capital and operating expenditures in western Canada. Approximately 22,000 wells were completed in 2006, of which approximately 70% were natural gas wells. In 2007, industry analysts forecast that drilling activity in western Canada will decline by approximately 20% to 18,000 wells of which 70% are expected to be natural gas wells, and that this reduction in drilling activity will reduce the need for natural gas capital expenditures on plant and equipment. It is also presently anticipated that the reduction in activity will occur primarily in the CBM and shallow gas markets. Many forecasters expect that, in the absence of significant discoveries, North American conventional natural gas production will decrease and that the declines in 2007 drilling activity will adversely affect the deliveries of natural gas. As sustaining or increasing production volumes is progressively more dependent upon development of shallow gas and CBM, both of which require more compression than traditional reservoirs, the decline in drilling activity is viewed by many as a temporary reaction to current market dynamics which should improve as production and deliveries of natural gas decline.

Competitive Issues in the Oil and Gas Service Industry

The availability of major components used in the fabrication of Enerflex's products and access to skilled personnel to meet the technical and trade requirements for designing and assembling these products are under increasing pressure on a worldwide basis. The expansion of Enerflex on a global basis assists Enerflex in managing these issues as it broadens the markets in which personnel can be accessed and it allows Enerflex to manage its inventory levels on a larger scale thus improving its supply chain. In addition to the various business risk factors outlined below investors should be aware of certain competitive issues in Canada, the United States and overseas markets.

Canada

The Canadian production and processing equipment and compressor packaging markets are very competitive. Several fabricators target the same customers as Enerflex and fabrication floor space is not a constraint. To be successful, Enerflex must compete on the basis of quality and service while remaining price competitive. The introduction of additional products is one way the Fund maintains its competitive position.

A number of new competitors have emerged for both the Mechanical Service and EI&C divisions. Enerflex is a market leader in Canada and maintains an extensive branch network, as proximity to customer locations is key to earning business. Enerflex believes its Mechanical Service division has a competitive advantage as the authorized Waukesha distributor. The EI&C division does not have exclusive distributorships, but has developed control technology to help differentiate its business from the competition.

While it is Enerflex's belief that more compression equipment is being rented each year in Canada, the majority of compression equipment, measured by horsepower, is owned by producers. Enerflex is a leader in the compression rental industry, supplying an estimated 30% of the Canadian market (calculated by horsepower). It is management's belief that a significant opportunity exists through the ownership, operation and management of compression facilities presently owned by natural gas producers. Enerflex is well suited to acquire such assets, reconfigure or replace the compression equipment to the corresponding production profile of the natural gas field and optimize the future compression needs as the future production profile changes. As such, the Fund will be pursuing investment opportunities for VCP in 2007 and future years.

United States

There are two major public competitors, one significant private competitor and a number of small regional competitors in the U.S. compression fabrication business. Management believes that the U.S. market may provide Enerflex with an opportunity to expand its business, through the supply of cold-weather compression packages from Enerflex's Canadian facilities.

The U.S. market continues to be more heavily weighted towards compression rentals than the Canadian market. Approximately 30% of the U.S. market is served by rental compression equipment while 70% is owned by producers and pipeline companies (calculated by horsepower). Enerflex plans to compete in certain niche markets where returns on capital are appropriate.

International

Internationally, Enerflex generally faces the same competitors as in North America. Most significant North American production equipment and compression fabricators pursue international business. International contacts developed by Presson, HPS and Mactronic, along with those compression products exported from Enerflex's Canadian facilities, have increased Enerflex's exposure to international opportunities, particularly in Pakistan, the Middle East and the Asia-Pacific markets.

In Australia Enerflex has significantly increased its profile and has improved its competitive potential for meeting the expanding natural gas infrastructure needs of the region. Enerflex has a history of successfully engineering, constructing and project managing the commissioning of natural gas production and distribution facilities in the range of $5 million to $50 million.

Risk Factors

While demand for Enerflex's products and services is largely a function of the supply, demand and price of natural gas, many other factors can affect the fortunes of the business either positively or negatively. The Fund encourages all investors to read and be aware of the risk factors and Enerflex's response to them.

Business Risks

Personnel

Enerflex's Engineered Systems segment requires skilled engineering and design professionals in order to maintain customer satisfaction and engage in product innovation. Enerflex competes for these professionals, not only with other companies in the same industry, but with oil and gas producers and other industries. In periods of high energy activity, demand for the skills and expertise of these professionals increases, making the hiring and retention of these individuals more difficult.

Both the Engineered Systems and Service segments rely on the skills and availability of trained and experienced tradesmen and technicians to provide efficient and appropriate services to Enerflex and its customers. Hiring and retaining such individuals is critical to the success of Enerflex's businesses. Demographic trends are reducing the number of individuals entering the trades, making Enerflex's access to skilled individuals more difficult. There are few barriers to entry in a number of Enerflex's businesses, so retention of staff is essential in order to differentiate Enerflex's businesses and compete in its various markets.

Additionally, in increasing measures, Enerflex is dependent upon the skills and availability of various professional and administrative personnel to meet the increasing demands of the requirements and regulations of various professional and governmental bodies, including but not limited to, the requirements of Bill 198 and the attendant securities regulations.

Internal and external training programs have become a key component to ensuring the availability of skilled personnel in all aspects of Enerflex's activities. Both the Engineered Systems and Service segments are active in apprenticeship programs and Enerflex has developed an ongoing retention program. Career development is encouraged through both in-house training and outside education centers and Enerflex has continued its initiatives to identify, train and retain skilled personnel for critical positions.

Energy Prices

Energy prices affect Enerflex, as the majority of Enerflex's customers generate cash flow from both crude oil and natural gas. The prices for these commodities are determined by supply, demand, government regulations relating to natural gas production and processing, and international political events, none of which can be accurately predicted. During 2006, crude light price per barrel ranged from U.S.$55.55 to a high of U.S.$77.75 and natural gas price per mcf ranged from CDN$3.53 to a high of CDN$9.54.

As free cash flow available for investment by producers varies with commodity prices, the market for capital goods required by Enerflex's customers is both cyclical and, at times, highly volatile. A sustained period of low natural gas prices, or oversupply, could negatively impact Enerflex's Engineered Systems businesses as natural gas producers would likely curtail investment in production equipment. Periods of extremely high natural gas prices can cause producers to delay routine maintenance on equipment, impacting the Service segment in the near-term.

Enerflex seeks to mitigate these risks through diversification in both products and services offered and geographical expansion.

Inflationary Pressures

Strong economic conditions and competition for available personnel, materials and major components have resulted in significant increases in the cost of obtaining such resources. To the greatest extent possible, Enerflex passes such cost increases on to its customers and it attempts to reduce these pressures through proactive procurement and human resource practices. Should these efforts not be successful, the gross margin and profitability of Enerflex could be adversely affected.

The Cyclical Nature of the Energy Industry

Changing political, economic or military circumstances throughout the energy producing regions of the world can impact the market price of oil for extended periods of time, which in turn impacts the price of natural gas, as industrial users often have the ability to choose to use the lower priced energy source.

Enerflex is structured to be profitable in both high and low periods of the energy cycle. This is done through product breadth, international diversification and access to a variety of equipment financing methods. Since becoming a publicly traded entity in 1993, Enerflex has generated positive cash flow even in challenging times.

Climatic Factors and Seasonal Demand

Demand for natural gas fluctuates largely with the heating and electrical generation requirements caused by the changing seasons in North America. Cold winters typically increase demand for, and the price of, natural gas. This increases customers' cash flow which can then have a positive impact on Enerflex. At the same time, access to many western Canadian oil and gas properties is limited to the period when the ground is frozen so that heavy equipment can be transported. As a result, the first quarter of the year is generally accompanied by increased winter deliveries of equipment. Warm winters in western Canada, however, can both reduce demand for natural gas and make it difficult for producers to reach well locations. This restricts drilling and development operations, reduces the ability to supply gas production in the short-term and can negatively impact the demand for Enerflex's products and services.

Enerflex seeks to reduce the impact of seasonality through geographic expansion and product diversification.

Credit Risk

A substantial portion of Enerflex's accounts receivable are with customers involved in the oil and natural gas industry, whose revenues may be impacted by fluctuations in commodity prices. During 2006, revenue from one customer accounted for 11% of Enerflex's total revenue. The ongoing consolidation of energy producers and the developing trend for smaller start-up exploration corporations increases Enerflex's exposure to credit risk.

Foreign Currency Exchange

Enerflex, with its Canadian base, is exposed to foreign exchange risk when it buys or sells goods or services in foreign currencies. As these foreign currencies depreciate against the Canadian dollar, it makes Enerflex's products exported from Canada more expensive in the foreign currency, while reducing the relative cost of inputs purchased in the same currency.

Enerflex manages most of this inherent risk through a variety of contractual means, but currency risk cannot be eliminated entirely. Enerflex has foreign subsidiaries in Australia, Indonesia, Malaysia, the Netherlands and the United States, and interests in affiliates and joint ventures in Pakistan and Germany. Enerflex has recently established a branch in Egypt. These expose Enerflex to changes in the exchange rates for the currencies of each country in addition to changes in the Canadian and U.S. dollars.

Foreign Operations

Enerflex sells products and services throughout the world. While this diversification is desirable, it can expose Enerflex to risks related to cultural, political and economic factors of foreign jurisdictions which are beyond the control of Enerflex. Other issues, such as the quality of receivables may also arise. Enerflex seeks to mitigate these risks by using staff experienced in foreign operations and monitoring the exposure it maintains in foreign currencies and international operations.

Distribution Agreements

One of Enerflex's strategic assets is its distribution and OEM agreements with leading manufacturers, notably the Waukesha Engine division of Dresser Inc., for engines and parts, and Ariel Corporation for compressors. In the event that one or more of these agreements were to be terminated, Enerflex would lose a competitive advantage. Enerflex and its people make it a priority to maintain and enhance these strategic relationships.

Enerflex, through its subsidiary HPS, has an agreement with Chemisch Thermische Prozesstechnick Gmbh of Austria to exclusively represent their products in Australia, including regenerative thermal oxidizers. This agreement is in effect until October 31, 2010 after which time it extends for annual one year renewal periods unless cancelled by either party.

Competition

Enerflex has a number of competitors in all aspects of its business, both domestically and abroad. Some of these competitors, particularly in the Engineered Systems segment, are large, multi-national companies with greater access to resources and more experience in international operations than Enerflex. Within Canada, particularly in the Service segment, Enerflex has a number of small to medium sized competitors, who may not have access to the capital and resources that Enerflex has, but may also incur lower overhead costs than the Fund.

Availability of Raw Materials, Component Parts or Finished Products

Enerflex purchases a broad range of materials and components in connection with its manufacturing and service activities. Enerflex purchases most of its compressors and engines through distributor agreements with Ariel Corporation for compressors and Waukesha Engine, a division of Dresser Inc., for natural gas engines and parts. Enerflex has had a relationship with both of these companies since 1980. Additionally, Enerflex has relationships with a number of other suppliers including Kobelco Compressors (America) Inc., Mycom Group Inc., and Caterpillar Inc. The availability of the component parts and the delivery schedules provided by these suppliers affect the assembly schedules of Enerflex's production and services.

Enerflex purchases coolers for its compression packages from a limited number of suppliers. The production schedules and delivery time tables from these suppliers affects the assembly schedule of Enerflex's products.

Though the Fund is generally not dependent on any single source of supply, the ability of suppliers to meet performance, quality specifications and delivery schedules is important to the maintenance of customer satisfaction.

A challenge to achieving improved profitability in 2007 will be the timely availability of certain OEM components and repair parts, which will be in steady demand.

Variable Cost Production

In 2005, Enerflex initiated a new service offering that, in addition to providing the potential for greater returns, expands its operational risks. Under the Variable Cost Production initiative, Enerflex will become responsible for the operation and performance of compression and processing facilities, which are often located in remote areas. These risks are anticipated to include: operational risks affecting facility operating hours; maintenance schedules and equipment failure; environmental risks associated with the operation of a gas compression facility; residual assets; and the estimates of the reservoir life and production characteristics. Enerflex will attempt to limit its exposure to these risks through contractual terms and conditions with its customers, modified insurance coverage and the introduction of certain procedures aimed at improving the monitoring capabilities of such facilities and the acquisition of specific skills and expertise required to effectively operate gas compression facilities, such as its 2005 investment in Total Production Services Inc., of Grande Prairie, Alberta.

Information Technology

As Enerflex continues to expand internationally, access engineering and other technical skills in foreign locations, develop web-based applications and monitoring products, and improve its business software applications, information technology assets and protocols will become increasingly important to Enerflex. Enerflex has attempted to reduce this exposure by improving its information technology general controls, updating or implementing new business applications and hiring or training specific employees with respect to the protection and use of information technology assets.

Environmental Considerations

Enerflex's customers, particularly in North America and Europe, are subject to significant and ever-increasing environmental legislation and regulation. This legislation can impact Enerflex both through increasing technical difficulty in meeting environmental requirements in product design, which could increase the cost of Enerflex's products, and a reduction in activity by producers in environmentally sensitive areas which would reduce the sales opportunities available.

At the same time, Enerflex itself operates in a number of jurisdictions and is also subject to environmental legislation and regulation. In order to maintain and enhance environmental compliance, Enerflex conducts routine property inspections and may engage third-party environmental companies to perform audits when deemed appropriate in the circumstances.

Insurance

Enerflex carries insurance to protect the Fund in the event of destruction or damage to its property and equipment, subject to appropriate deductibles and the availability of coverage. Liability insurance is also maintained at prudent levels to limit exposure to unforeseen incidents. An annual review of insurance coverage is completed to assess the risk of loss and risk mitigation alternatives. Extreme weather conditions, natural occurrences and terrorist activity have strained insurance markets leading to substantial increases in insurance costs and limitations on coverage.

Credit Facility and Senior Secured Notes

The Fund depends on the Bank Facility and senior secured notes to maintain sufficient cash flow for its operations and capital programs. The senior secured notes are due $21 million on December 20, 2013 and $79.6 million on December 20, 2016. Interest is fixed at a weighted average rate of 5.41%. The Bank Facility is due on June 30, 2009 and may be renewed annually. If the Fund cannot extend the Bank Facility prior to its due date, the cash available for distributions to unitholders would be adversely affected.

The Credit Agreement and Note Purchase Agreement also contain a number of covenants. Failure to meet any of these covenants, financial ratios or financial tests could result in events of default under each agreement. These events would restrict when distributions may be made by the Fund and the other guarantors thereunder.

Risks Related to the Structure of the Fund

Nature of Trust Units

The Trust Units do not represent a traditional investment in the energy services sector. The Trust Units represent a fractional interest in the Fund. As holders of Trust Units, Trust Unitholders have substantially all of the same protections, rights and remedies as a shareholder would have under the CBCA except that a Unitholder will not have the statutory rights normally associated with ownership of shares of a corporation including, for example, the right to bring "oppression" or "derivative" actions. A Trust Unitholder is also not entitled to "dissent rights".

The Fund's sole assets will be its holding of common shares in the Administrator, the trust units of the Trust, the notes of the Trust and other investments in securities of its subsidiaries. The price per Trust Unit is a function of anticipated Distributable Cash, the underlying assets of the Fund and management's ability to effect long-term growth in the value of the Fund. The market price of the Trust Units will be sensitive to a variety of market conditions including, but not limited to, interest rates and the ability of the Fund to maintain or grow its business. Changes in market conditions may adversely affect the trading price of the Trust Units.

Dilution

The Deed of Trust authorizes the Fund to issue an unlimited number of Trust Units for the consideration and on such terms and conditions as are established by the Administrator without any approval of Trust Unitholders. The Fund may issue additional Trust Units in the future to directly or indirectly fund capital expenditure requirements of the Company and other entities now or hereafter owned directly or indirectly by the Fund, including to finance acquisitions by those entities. Trust Unitholders will have no pre-emptive rights in connection with such additional issues. The Administrator has discretion in connection with the price and the other terms of the issue of such additional Trust Units. In addition, the Partnership is permitted to issue additional Exchangeable LP Units for any consideration and on any terms and conditions.

Unpredictability and Volatility of Trust Unit Price

A publicly-traded income trust will not necessarily trade at values determined by reference to the underlying value of its business. The prices at which the Trust Units will trade cannot be predicted. The market price of the Trust Units could be subject to significant fluctuations in response to variations in quarterly operating results, distributions and other factors beyond the control of the Fund. The annual yield on the Trust Units as compared to the annual yield on other financial instruments may also influence the price of Trust Units in the public markets. In addition, public markets have experienced significant price and volume fluctuations from time to time in recent years that often have been unrelated or disproportionate to the operating performance of particular issuers. These broad fluctuations may adversely affect the market price of the Trust Units.

Nature of Distributions

Unlike interest payments on an interest-bearing security, cash distributions by income trusts on trust units (including those of the Fund) are, for Canadian tax purposes, composed of different types of payments (portions of which may be fully or partially taxable or may constitute non-taxable "returns of capital"). The composition for tax purposes of those cash distributions may change over time, thus affecting the after-tax return to Trust Unitholders. Therefore, a Trust Unitholder's rate of return over a defined period may not be comparable to the rate of return on a fixed-income security that provides a return on capital over the same period. This is because a Trust Unitholder may receive cash distributions that constitute a return of capital (rather than a return on capital) to some extent during the relevant period. Returns on capital are generally taxed as ordinary income or as dividends in the hands of a Trust Unitholder while returns of capital are generally non-taxable to a Trust Unitholder (but reduce a Trust Unitholder's cost base in the Trust Unit for tax purposes). Trust Unitholders are advised to consult their own tax advisors with respect to the implications of the distinction discussed above in their own circumstances.

Variability of Distributions

Although the Fund intends to distribute approximately 65% of Cash Available for Distribution, Cash Available for Distribution to Trust Unitholders and holders of Exchangeable LP Units is a function of numerous factors beyond the control of the Fund, including Enerflex's financial performance, the impact of interest rates, the growth of the general economy, the price of crude oil and natural gas, weather, debt covenants and obligations, working capital requirements, future capital requirements and the number of Trust Units and Exchangeable LP Units outstanding. Depending on the operations of Enerflex and the performance of its assets, distributions may be reduced or suspended entirely.

The market value of the Trust Units may deteriorate if the Fund is unable to meet its cash distribution targets in the future, and that deterioration may be material. In addition the composition of cash distributions for tax purposes may change over time and may affect the after-tax return for Trust Unitholders.

Structural Subordination of the Trust Units

In the event of a bankruptcy, liquidation or reorganization of the Fund, the Administrator, the Partnership, the Company or any of their affiliates, holders of certain of their indebtedness and certain trade creditors will generally be entitled to payment of their claims from the assets of such entities before any assets are made available for upstream distribution, eventually to the Fund. The Trust Units are subordinated pursuant to the Credit Agreement, Note Purchase Agreement, to senior credit facilities and most of the other indebtedness and liabilities of the Fund and its affiliates.

Capital Investment

The timing and amount of capital expenditures by the Company and its affiliates will directly affect the amount of Cash Available for Distribution to Trust Unitholders and holders of Exchangeable LP Units. Distributions to Trust Unitholders and holders of Exchangeable LP Units may be reduced, or even eliminated, at times when the Administrator deems it necessary to make significant capital or other expenditures.

Cash Available for Distribution may be dependent upon the ability of Enerflex to fund a portion of its capital expenditures and working capital with cash generated from operations. The Fund may be required to reduce distributions or sell additional Trust Units in order to accommodate these items. There can be no assurance that sufficient capital will be available on acceptable terms to the Fund for necessary or desirable capital expenditures or that the amount required will be the same as currently estimated.

Restrictions on Potential Growth

The payout by the Company of a substantial portion of its operating cash flow will make additional capital and operating expenditures dependent on increased cash flow or additional financing in the future. Lack of those funds could limit the future growth of Enerflex and its cash flow, which in turn may affect the amount of distributions by the Fund and the Partnership to Trust Unitholders and holders of Exchangeable LP Units. In addition, Enerflex may be precluded from pursuing otherwise attractive acquisitions or investments because they may not be accretive on a short-term basis.

Limitation on Non-Resident Ownership and Liquidity

The Deed of Trust imposes various restrictions on Unitholders. Trust Unitholders who are non-residents of Canada for the purposes of the Tax Act are prohibited from beneficially owning more than 49% of the outstanding Trust Units (on a non-diluted and fully-diluted basis). These restrictions may limit (or inhibit the exercise of) the rights of certain persons, including non-residents, to acquire Trust Units, to exercise their rights as Trust Unitholders and to initiate and complete take-over bids in respect of the Trust Units. As a result, these restrictions may limit the demand for Trust Units from certain Trust Unitholders and other investors and thereby adversely affect the liquidity and market value of the Trust Units held by the public.

Future Sales of Trust Units

The sales of a substantial number of Trust Units in the public market or otherwise by Trust Unitholders could adversely affect the prevailing market price of the Trust Units and could impair the Fund's ability to raise additional capital through an offering of its equity securities. If former Shareholders sell a large number of Trust Units over a short period of time, or if investors anticipate large sales of Trust Units over a short period of time, this could affect the trading price of the Trust Units and the affect could be material.

Changes in Legislation

There can be no assurance that federal, provincial or foreign tax laws will not be changed in a manner that adversely affects the Distributions or the holders of Trust Units and Exchangeable LP Units. Environmental and applicable operating legislation may be changed in a manner which adversely affects Unitholders.

On October 31, 2006, the Finance Minister of the Government of Canada announced proposed changes to the Income Tax Act of Canada (the "2006 Proposals"). It is expected that the 2006 Proposals, if enacted in their currently proposed form, will subject the Fund to trust level taxation beginning on January 1, 2011, which will materially reduce the amount of cash available for distributions to Unitholders. Based on the proposed rate of such tax, the Fund estimates that the enactment of the 2006 Proposals will, commencing on January 1, 2011, reduce the amount of cash available to the Fund to distribute to its Unitholders by an amount equal to 31.5% multiplied by the amount of the pretax income distributed by the Fund. A reduction in the value of the Trust Units would be expected to increase the cost to the Fund of raising capital in the public capital markets. There can be no assurance that the Fund will be able to reorganize its legal and tax structure to reduce the expected impact of the 2006 Proposals. In addition, there can be no assurance that the Fund will be able to maintain its status as a Grandfathered SIFT under the 2006 Proposals until 2011. If the Fund is deemed to have undergone "undue expansion" during the transitional period from October 31, 2006 to December 31, 2010, the 2006 Proposals will become effective on a date earlier than January 1, 2011. Loss of status as a Grandfathered SIFT could have a material and adverse effect on the value of the Trust Units.

No assurance can be given as to the final provisions of any legislation that may be enacted to implement the 2006 Proposals. The terms of such provisions may differ from those described herein, possibly in ways that would be materially adverse to the Fund and the Unitholders.

Investment Eligibility

If the Fund ceases to qualify as a "mutual fund trust" as defined in the Tax Act, the Trust Units will cease to be qualified investments for Exempt Plans which will have adverse tax consequences to Exempt Plans or their annuitants or beneficiaries.

Distributions on Redemption or Termination of the Fund

It is anticipated that the redemption right will not be the primary mechanism for Trust Unitholders to liquidate their investment. Securities which may be received as a result of a redemption of Trust Units will not be listed on any stock exchange and no market for such securities is expected to develop. The securities so distributed may not be qualified investments for Exempt Plans, depending upon the circumstances existing at that time. On termination of the Fund, the Trustee may distribute securities directly to Trust Unitholders, subject to obtaining all of the necessary regulatory approvals. In addition, there may be resale restrictions imposed by Applicable Laws upon the recipients of securities pursuant to the redemption right.

Debt Service

The Company and its affiliates may, from time to time, finance a significant portion of their operations through debt. Amounts paid in respect of interest and principal on debt incurred by the Company and its affiliates may impair the Company's and its affiliates' ability to satisfy their obligations under their debt instrument(s). Variations in interest rates and scheduled principal repayments could result in significant changes in the amount required to be applied to debt service before payment of inter-entity debt. Ultimately, this may result in lower levels of Distributable Cash for the Fund.

Dependence on the Company and its Affiliates

The Fund is an open-ended, limited purpose trust, which will, for purposes of its income, be entirely dependent on the Company (and its affiliates). Although the Fund intends to distribute the interest on the notes of the Trust and distributions on the trust units received from the Trust, less expenses and amounts, if any, paid by the Fund in connection with the redemption of Trust Units and other permitted deductions, there can be no assurance regarding the Fund's ability to make distributions, which remains dependent upon the ability of the Trust to pay its interest obligations under the notes of the Trust and to pay distributions or other returns of capital in respect of the trust units of the Trust, which ability, in turn, is dependent upon the operations and assets of the Company (and its affiliates).

Unitholder Limited Liability

The Deed of Trust provides that no Unitholder will be subject to any liability in connection with the Fund or its obligations and affairs and, in the event that a court determines Unitholders are subject to any such liabilities, the liabilities will be enforceable only against, and will be satisfied only out of the Fund's assets. Pursuant to the Deed of Trust, the Fund will indemnify and hold harmless each Unitholder from any costs, damages, liabilities, expenses, charges and losses suffered by a Unitholder resulting from or arising out of such Unitholder not having such limited liability.

The Deed of Trust provides that all written instruments signed by or on behalf of the Fund must contain a provision to the effect that obligations under those instruments will not be binding upon Unitholders personally. Personal liability may however arise in respect of claims against the Fund that do not arise under contracts, including claims in tort, claims for taxes and possibly certain other statutory liabilities. The possibility of any personal liability of this nature arising is considered unlikely.

The Income Trusts Liability Act (Alberta) came into force on July 1, 2004. The legislation provides that a Unitholder will not be, as a beneficiary, liable for any act, default, obligation or liability of the Trustee that arises after the legislation came into force. However, this legislation has not yet been ruled on by the courts.

The operations of the Fund will be conducted, upon the advice of counsel, in such a way and in such jurisdictions as to avoid as far as possible any material risk of liability to the Unitholders for claims against the Fund, including by obtaining appropriate insurance, where available and to the extent commercially feasible.

management's responsibility for financial information

TO THE UNITHOLDERS OF ENERFLEX SYSTEMS INCOME FUND;

The accompanying consolidated financial statements and all information in the Annual Report have been prepared by management and approved by the Board of Directors of Enerflex Holdings General Partner Ltd., acting as administrator of the Fund. The consolidated financial statements have been prepared in accordance with generally accepted accounting principles in Canada and, where appropriate, reflect management's best estimates and judgements. Management is responsible for the accuracy, integrity and objectivity of the consolidated financial statements within reasonable limits of materiality and for the consistency of financial data included in the text of the Annual Report with that in the consolidated financial statements.

To assist management in the discharge of these responsibilities, the Fund maintains a system of internal controls designed to provide reasonable assurance that accounting records are reliable and assets are safeguarded.

The Audit Committee is appointed by the Board of Directors. The Audit Committee meets with management, as well as with the external auditors, to satisfy itself that management is properly discharging its financial reporting responsibilities and to review the consolidated financial statements and the auditors' report. The Audit Committee reports its findings to the Board of Directors for consideration in approving the consolidated financial statements for presentation to the unitholders. The external auditors have direct access to the Audit Committee of the Board of Directors.

The consolidated financial statements have been audited independently by Deloitte & Touche LLP on behalf of the unitholders in accordance with generally accepted auditing standards. Their report outlines the nature of their audits and expresses their opinion on the consolidated financial statements.

J. Blair Goertzen
President and Chief Executive Officer

Leonard A. Cornez
Vice-President and Chief Financial Officer

February 7, 2007

TO THE UNITHOLDERS OF ENERFLEX SYSTEMS INCOME FUND;

We have audited the consolidated balance sheets of Enerflex Systems Income Fund (the "Fund") as at December 31, 2006 and 2005 and the consolidated statements of income, retained earnings and cash flows for the years then ended. These financial statements are the responsibility of Enerflex Holdings General Partners Ltd., acting as an administrator of the Fund. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Deloitte & Touche LLP
Chartered Accountants

Calgary, Alberta
February 7, 2007

Consolidated Balance Sheets

(Thousands) December 31,	2006	2005
ASSETS		
Current assets		
Cash	**$ 22,344**	$ 16,350
Accounts receivable	**157,257**	163,899
Inventory (Note 2)	**112,826**	84,378
Future income taxes (Note 8)	**4,876**	3,983
Total current assets	**297,303**	268,610
Rental equipment (Note 3)	**106,108**	90,348
Property, plant and equipment (Note 4)	**69,967**	65,585
Assets under construction (Note 4)	**3,743**	3,374
Investment in affiliates	**2,864**	2,797
Future income taxes (Note 8)	**5,505**	4,868
Deferred financing costs	**814**	–
Intangible assets	**7,666**	7,355
Goodwill	**125,204**	121,378
	$ 619,174	$ 564,315
LIABILITIES AND UNITHOLDERS' EQUITY		
Current liabilities		
Operating bank loans (Note 5)	**$ –**	$ 43,310
Accounts payable and accrued liabilities	**84,166**	90,561
Accrued dividends payable	**–**	2,260
Accrued distributions payable	**11,669**	–
Income taxes payable	**1,459**	7,612
Current portion of long-term debt (Note 5)	**–**	12,717
Total current liabilities	**97,294**	156,460
Long-term debt (Note 5)	**133,557**	63,587
Other long-term liabilities	**1,662**	1,969
Future income taxes (Note 8)	**13,670**	13,042
	246,183	235,058
Guarantees, commitments and contingencies (Note 6)		
Unitholders' equity		
Unitholders' capital (Note 9)	**205,454**	184,151
Cumulative translation adjustment	**(1,917)**	(6,250)
Contributed surplus (Note 10)	**71**	1,739
Retained earnings	**169,383**	149,617
	372,991	329,257
	$ 619,174	$ 564,315

See accompanying Notes to the Consolidated Financial Statements.

P. John Aldred
Director

Robert B. Hodgins
Director

Consolidated Statements Of Income

(Thousands, except unit amounts) Years Ended December 31,	**2006**	2005
Revenue	**$ 792,330**	$ 670,612
Cost of goods sold	**617,060**	524,667
Gross margin	**175,270**	145,945
Selling, general and administrative expenses	**105,680**	85,523
Reorganization costs (Note 14)	**9,713**	–
Foreign currency gains	**(1,484)**	(2,212)
Gain on sale of assets	**(5,162)**	(2,622)
Equity earnings from affiliates	**(68)**	–
Income before interest and income taxes	**66,591**	65,256
Interest	**7,336**	4,641
Income before income taxes	**59,255**	60,615
Income taxes (Note 8)	**18,504**	20,523
Net income	**$ 40,751**	$ 40,092
Net income per unit – basic (Note 12)	**$ 0.89**	$ 0.89
– diluted	**$ 0.89**	$ 0.89
Weighted average number of units	**45,710,389**	45,039,952

Consolidated Statements Of Retained Earnings

(Thousands) Years Ended December 31,	**2006**	2005
Retained earnings, beginning of period	**$ 149,617**	$ 118,540
Normal course issuer bid (Note 9)	**(803)**	–
Net income	**40,751**	40,092
Dividends	**(8,513)**	(9,015)
Distributions	**(11,669)**	–
Retained earnings, end of period	**$ 169,383**	$ 149,617

See accompanying Notes to the Consolidated Financial Statements.

Consolidated Statements Of Cash Flows

(Thousands) Years Ended December 31,	2006	2005
Operating Activities		
Net income	**$ 40,751**	$ 40,092
Depreciation and amortization	**20,124**	16,139
Future income taxes	**(2,206)**	(3,072)
Gain on sale of assets	**(5,162)**	(2,622)
Equity earnings from affiliates	**(68)**	–
Stock option expense	**4,475**	849
Unit option expense	**71**	–
	57,985	51,386
Changes in non-cash working capital and other	**(42,388)**	(29,873)
	15,597	21,513
Investing Activities		
Acquisition of HPS (Note 1)	**(4,138)**	(16,795)
Acquisition of Onstream (Note 1)	**(5,896)**	–
Acquisition of interest in affiliate	**–**	(2,762)
Purchase of:		
Rental equipment	**(31,754)**	(22,939)
Property, plant and equipment	**(16,370)**	(7,446)
Assets under construction	**(3,580)**	(3,374)
Proceeds on disposal of:		
Rental equipment	**17,617**	17,650
Property, plant and equipment	**8,596**	1,326
	(35,525)	(34,340)
Changes in non-cash working capital and other	**(2,033)**	(3,665)
	(37,558)	(38,005)
Financing Activities		
Increase (decrease) in operating bank loans	**(43,310)**	14,456
Advance of long-term debt	**57,638**	13,512
Stock options exercised	**15,407**	2,456
Normal course issuer bid	**(1,122)**	–
Dividends	**(10,773)**	(8,989)
	17,840	21,435
Changes in non-cash working capital and other	**10,115**	(1,433)
	27,955	20,002
Increase in cash	**5,994**	3,510
Cash, beginning of period	**16,350**	12,840
Cash, end of period	**$ 22,344**	$ 16,350

See accompanying Notes to the Consolidated Financial Statements.

Supplemental disclosure of cash flow information (Note 15).

(Tabular dollar amounts in thousands, except per unit and option amounts)

Summary Of Accounting Policies

The consolidated financial statements are prepared in accordance with generally accepted accounting principles in Canada. Certain prior year amounts have been reclassified to conform with the current year's presentation.

Incorporation and Basis of Presentation

Enerflex Systems Income Fund (the "Fund") is an open-ended mutual fund trust governed by the laws of Alberta pursuant to a Deed of Trust dated August 22, 2006. On October 2, 2006, the Fund, Enerflex Systems Holdings Trust (the "Trust"), Enerflex Holdings Limited Partnership (the "Partnership"), Enerflex Holdings General Partner (the "General Partner"), Enerflex Systems Ltd. (the "Company") and Enerflex Acquisition Ltd. ("AcquisitionCo") completed an Arrangement Agreement (the "Arrangement") dated August 25, 2006, the purpose of which was to convert the Company from a corporate structure into an income trust. Pursuant to the Arrangement, the Company and AcquisitionCo amalgamated and continued as one corporation. Upon completion of the Arrangement, all of the shares of the Company were owned by the Partnership and indirectly by the Fund.

Prior to the Arrangement effective date of October 2, 2006, the consolidated financial statements included the accounts of the Company, its subsidiaries, its equity interest in affiliates, and its 46.5% interest in the Presson Descon International (Private) Limited joint venture. The conversion to a trust has been accounted for on a continuity of interest basis and accordingly, the consolidated financial statements reflect the financial position, results of operations and cash flows as if the Fund had always carried on the business formerly carried on by the Company. Due to the conversion to a trust, certain information included in the consolidated financial statements for prior periods may not be directly comparable. For purposes of these financial statements, the share capital of the Fund is reported under Unitholder Capital (Note 9). Pursuant to the Arrangement, shareholders received either trust units or a combination of trust units and exchangeable LP units of the Partnership for previously held shares of the Company. After giving effect to the Arrangement, the consolidated financial statements include the accounts of the Fund, its subsidiaries and its partnerships.

The beneficiaries of the Fund are the holders of the Fund units and the partners of the Partnership are the holders of exchangeable LP units. The quarterly distributions made by the Fund are determined by the Trustees. The Partnership earns interest income from a promissory note. The Partnership in substance pays distributions to holders of exchangeable LP units in amounts equal to the distributions paid to the holders of Fund units. All distributions are made to unitholders of record on the last business day of each quarter.

Investment in Affiliates

The Fund uses the equity method to account for its 40% investment in Total Production Services Inc., an investment subject to significant influence.

Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and contingencies at the date of the consolidated financial statements, and revenues and expenses during the reporting period. Actual results could differ from those estimated. Significant estimates in the financial statements include percentage of completion of fabrication contracts, allowance for doubtful accounts receivable, depreciation and amortization, overhaul accrual, obsolescence provisions, warranty obligations, asset and liability valuations, and commitments and contingencies.

Revenue Recognition

Revenues from the design, fabrication and installation of compression and power generation equipment are recorded using the percentage of completion method. Revenues from the fabrication, construction and installation of production and processing facilities and equipment are recognized using the percentage of completion method. Unearned revenue is applied against work in progress for financial statement presentation. Any foreseeable losses on contracts are charged to income at the time they become evident. Revenues from discrete parts and service sales are recorded when goods are shipped and services rendered. Revenues from the provision of integrated parts and service work are recognized on completion of the work. Revenue from equipment rental and leases is recorded over the rental or lease term. In 2006 and 2005, substantially all revenue from equipment leases was from operating leases.

Unit-based Compensation Plans

The Fund's unit-based compensation plans are described in Note 11.

Trust Unit Options – The Fund uses the fair value method of accounting for stock/trust unit options issued on or after January 1, 2002. The value of options is calculated using a modified Black-Scholes method at the time of issuance, and is charged to income over the vesting period. Consideration paid by employees on exercise of stock/trust unit options is credited to unitholders' capital, along with the related value previously expensed. No compensation expense is recognized on options granted before January 1, 2002.

Restricted Trust Units – Restricted Trust Units ("RTUs") represent indexed liabilities of the Fund relative to the Fund's unit price.

During the vesting period, the Fund records, as a compensation expense, an allocated portion of the market value of the number of units expected to vest under the plan. RTUs granted vest subject to the continued employment of the employee and the passage of a predetermined period of time, as set by the Board of Directors. During the vesting period, the compensation expense is recognized based on management's best estimate of the number of RTUs expected to vest based on management's best estimates of whether the criteria will be met. The accrued liability is marked to market at each period end, through a charge to compensation expense, and allocated between current and long-term liabilities based on when the amount becomes payable.

Performance Trust Units – Performance Trust Units ("PTUs") represent indexed liabilities of the Fund relative to the Fund's unit price.

During the vesting period, the Fund records, as a compensation expense, an allocated portion of the market value of the number of units expected to vest under the plan. PTUs granted vest subject to the continued employment of the employee, the passage of a predetermined period of time, and performance criteria to be achieved as set by the Board of Directors. During the vesting period, the compensation expense is recognized based on management's best estimate of the number of PTUs expected to vest based on management's best estimates of whether the criteria will be met. The accrued liability is marked to market at each period end, through a charge to compensation expense, and allocated between current and long-term liabilities based on when the amount becomes payable.

Phantom Trust Units – The Fund maintains a Phantom Trust Unit (unit appreciation rights) ("UARs") Plan for those employees in jurisdictions other than Canada for whom the Fund's Trust Unit Option Plan would have negative personal taxation consequences.

UARs represent an indexed liability of the Fund relative to the Fund's unit price.

During the vesting period, the Fund records as a compensation expense, an allocated portion of the difference between the market value of the number of rights expected to vest under the plan and the strike prices of those rights based on management's best estimate of the number of rights expected to ultimately vest. The accrued liability is marked to market at each period end, through a charge to compensation expense.

Foreign Currency Translation

Transactions and non-monetary balances denominated in a foreign currency are translated into Canadian dollars using the exchange rates at the dates of the transactions; monetary balances are translated using the exchange rate at the date of the balance sheet.

The assets and liabilities of foreign operations considered financially and operationally independent are translated into Canadian dollars from their functional currencies using exchange rates at the balance sheet dates. Revenue and expense items are translated using the average rates of exchange throughout the year. Gains and losses resulting from this translation process are included in the cumulative translation adjustment in unitholders' equity in the consolidated balance sheets.

The monetary assets and liabilities of foreign operations not considered financially and operationally independent are translated into Canadian dollars from their functional currencies using exchange rates at the balance sheet dates. Non-monetary assets and liabilities denominated in foreign currency are translated into Canadian dollars using the exchange rates at the dates of the transactions. Revenue and expense items are translated using the average rates of exchange throughout the year. Gains and losses resulting from this translation process are included in net income of the period.

Pension Arrangements

Defined contribution plan costs, which constitute the Fund's major pension arrangement, are expensed by the Fund in the period that the contributions are payable.

The Fund maintains a defined benefit pension plan within its European business unit. Pension costs and obligations are determined using the projected benefit method and are charged to earnings as services are rendered.

Defined benefit pension plan assets are measured at fair value and the expected return on these assets is calculated using the fair value method. Past service costs arising from plan amendments are amortized on a straight-line basis over the average remaining service period of active employees. Transitional amounts recognized upon the adoption of the standard are amortized on a straight-line basis over a period of five years. Net actuarial gains and losses are amortized over the average remaining service period of active employees.

Actuaries perform valuations on a regular basis to determine the actuarial present value of the accrued defined benefit pension benefits. The measurement date used to determine the plan assets and the accrued benefit obligation was December 31, 2006.

Warranty Obligations

The Fund accrues a liability for warranty obligations on the basis of historical claims experience, as a percentage of revenue, specific to each business unit. Warranty costs incurred are charged against this liability.

Deferred Financing Costs

Costs associated with the issuance of long-term debt are deferred and amortized by the effective interest method over the term of the debt. The amortization is included in interest expense.

Income Taxes

The Fund uses the liability method of accounting for income taxes. Under this method, temporary differences between the tax basis of the Fund's assets and liabilities and their carrying amounts result in future income tax assets and liabilities. Future income taxes are measured using income tax rates that, at the balance sheet date, are expected to apply when the liability is settled or the asset is realized.

Exchangeable Units

Exchangeable units are presented as equity of the Fund as their features make them economically equivalent to fund units.

Earnings Per Unit

Basic earnings per unit are calculated using the weighted average units outstanding in the period. The Fund uses the treasury stock method of calculating diluted earnings per unit.

Share and per share amounts prior to the trust conversion on October 2, 2006 are referred to as unit or per unit amounts in the consolidated financial statements.

Cash

Includes cash amounts and cheques in excess of cash on deposit not included in the Fund's credit facility and, therefore, not subject to netting, and cash equivalents, being all highly liquid investments with original maturities of three months or less.

Inventory

Manufacturing materials are recorded at the lower of cost (principally on the first-in, first-out method) and net realizable value. Repair parts are recorded at the lower of weighted average cost and net realizable value. Work in progress includes material, labour and manufacturing overhead, and is recorded net of unearned revenue on a contract by contract basis.

Rental Equipment

Rental equipment is recorded at cost. Depreciation is provided using the straight-line method over the estimated useful lives of the assets; which are generally between 5 and 15 years.

When, under the terms of a rental contract, the Fund is responsible for maintenance and overhauls, the expense is accrued monthly to match maintenance expense with the related revenue. Maintenance and overhaul costs incurred are charged to the accrued maintenance liability and are not capitalized.

Major renewals and improvements are capitalized. No depreciation is provided on assets under construction. Repairs and maintenance costs are charged to operations as incurred.

Rental equipment is assessed for impairment whenever changes in events or changes in circumstances indicate that the carrying value may not be recoverable.

Property, Plant and Equipment

Property, plant and equipment are recorded at cost. Depreciation is provided using the straight-line method over the estimated useful lives of the various classes of assets:

Asset Class	Estimated Useful Life Range
Buildings	5 to 25 years
Equipment	2 to 20 years

Major renewals and improvements are capitalized. No depreciation is provided on assets under construction. Repairs and maintenance costs are charged to operations as incurred.

Property, plant and equipment are assessed for impairment whenever changes in events or changes in circumstances indicate that the carrying value may not be recoverable.

Intangible Assets

Intangible assets represent the fair value of assets at the date of acquisition that result from contractual or other legal rights or are capable of being separated or divided from the acquired enterprise and sold, transferred, licensed, rented or exchanged. All of the Fund's intangible assets are as a result of business combinations. Intangible assets are amortized over management's best estimate of the expected life of the asset. Intangible assets are assessed for impairment at least annually.

Goodwill

Goodwill represents the excess of the purchase price over the value attributed to net tangible and intangible assets acquired.

Goodwill is assessed for impairment at least annually. The impairment test is based on management's best estimate of the fair value of the related segments compared to the carrying amounts of those segments.

Note 1. Acquisitions

HPS Group Pty Limited

On July 6, 2005, the Fund acquired 100% of the issued and outstanding common shares of HPS Group Pty Limited ("HPS"), of Perth, Australia. The total purchase consideration was $24,448,000 (AUD$25.8 million), comprised of $21,601,000 (AUD$22.8 million) in cash and $2,847,000 (AUD$3.0) million paid by the issuance of 122,176 common shares of Enerflex Systems Ltd. at $23.30 per share. Total transaction costs were $775,000.

Subject to the achievement of various performance measures and future earnings targets in the HPS twelve month period ended June 30, 2006, a maximum contingent consideration of AUD$5.0 million could be paid in July of 2006 to the vendors, certain of whom are employees of HPS. As HPS met the prescribed targets, the vendors were awarded the maximum contingent consideration of $4,138,000 (AUD $5 Million). The full amount has been applied to the final purchase price allocation and has been allocated as Goodwill.

The acquisition was accounted for as a purchase and the results of the operation of HPS have been included with those of the Fund from the date of acquisition.

Below is the final purchase price allocation.

Purchase price:	
Consideration	$ 25,739
Shares	2,847
Transaction costs	775
Total purchase price	$ 29,361
Assets acquired:	
Cash	$ 5,581
Net non-cash working capital	1,500
Property, plant and equipment	2,243
Intangible assets	5,901
Goodwill	15,366
Future income taxes	(1,042)
Non-current liabilities	(188)
	$ 29,361

Onstream Compressor Rentals Inc.

On October 9, 2006, the Fund acquired 100% of the issued and outstanding common shares of Onstream Compressor Rentals Inc. ("Onstream"). Onstream's business had been focused on renting large horsepower trailer mounted reciprocating compressor packages for short term rental applications. These short term rental applications will be used during an overhaul or revamp and provide the customer with minimal disruption in gas sales during compressor interruption.

The total purchase consideration was $5,796,000 in cash, funded through the Fund's existing credit facilities. There is no contingent consideration. Total transaction costs have been estimated at $100,000.

The Onstream business was rolled into Production Services and the use of the Onstream name has been discontinued. The acquisition has been accounted for as a purchase and the results of the operations of Onstream have been included with those of the Fund from the date of acquisition.

Purchase price:	
Cash	$ 5,796
Transaction costs	100
Total purchase price	$ 5,896

Assets acquired:	
Net non-cash working capital	$ 1,713
Future income tax asset	94
Rental assets	7,175
Fixed assets	93
Intangibles	203
Bank overdraft	(269)
Capital lease payable	(1,366)
Overhaul provision	(300)
Future income tax liability	(1,447)
	$ 5,896

Note 2. Inventory

December 31,	**2006**	2005
Finished goods	**$ 13,769**	$ 9,038
Manufacturing materials	**29,329**	18,420
Repair parts held for resale	**44,198**	36,608
Work in progress:		
Costs in excess of related billings	**30,126**	26,183
Billings in excess of related costs	**(4,596)**	(5,871)
	$ 112,826	$ 84,378

Note 3. Rental Equipment

December 31,	2006	2005
Cost	$ 134,532	$ 113,771
Less accumulated depreciation	(28,424)	(23,423)
Net book value	$ 106,108	$ 90,348

Depreciation of rental equipment, which was included in cost of goods sold, was $9,629,000 in 2006 (2005 – $7,394,000).

Note 4. Property, Plant And Equipment

December 31,	2006		2005	
	Cost	Accumulated Depreciation	Cost	Accumulated Depreciation
Land	$ 9,352	$ –	$ 9,127	$ –
Buildings	59,756	(19,764)	57,154	(15,741)
Equipment	61,583	(40,960)	57,570	(42,860)
Assets under construction	3,743	–	3,374	–
Asset held for sale	–	–	411	(76)
Total	$ 134,434	$ (60,724)	$ 127,636	$ (58,677)
Net book value		$ 73,710	–	$ 68,959

Depreciation of property, plant and equipment included in income in 2006 was $7,880,000 of which $2,253,000 was included in cost of goods sold and $5,627,000 was included in selling, general and administrative expenses. Depreciation of property, plant and equipment included in income in 2005 was $7,933,000 of which $3,244,000 was included in cost of goods sold and $4,689,000 was included in selling, general and administrative expenses.

Note 5. Operating Bank Loans And Long-term Debt

On December 20, 2006 the Fund completed the restructuring of its debt with the closing of a private placement and the amendment and restatement of its bank facility.

The Fund obtained the new debt financing through the issuance, by way of private placement, of $100.6 million of Senior Secured Notes ("Notes"). The Notes mature on two separate dates with $21.0 million, at an interest rate of 5.28%, maturing on December 20, 2013 and $79.6 million, with an interest rate of 5.45%, maturing on December 20, 2016.

The net proceeds from this private placement were used to repay a portion of the Fund's existing bank credit facility. Concurrent with the closing of the private placement financing, the Fund also amended and revised it bank credit facility ("Bank Facility") with three banks. The Bank Facility provides a $150 million 3 year revolving credit facility. The Bank Facility matures on June 30, 2009 and is extendible at the banks' option in June of each year.

The Fund may borrow under the Bank Facility through Canadian Prime Advance and Bankers' Acceptance ("BAs") in Canadian dollars; and U.S. Base Rate loans and London Interbank Offer Rate ("LIBOR") in U.S. dollars. The applicable margin is determined by the Fund's Consolidated Debt to EBITDA[1] ratio. The Fund may also draw on the Bank Facility through bank overdrafts in either Canadian or U.S. dollars and letters of credit.

Under the Bank Facility, a margin is paid in addition to the quoted interest rate. The margin is established in basis points ("bps") and is based on Consolidated Debt to EBITDA[1] ratio. The margin is adjusted effective the first day of the third month following the end of each fiscal quarter as follows:

	Borrowings	
	LIBOR, BAs Letters of Credit	Canadian Prime U.S. Base Rate
Consolidated debt to EBITDA[1] ratio		
< 1.0 to 1.0	90 bps	–
≥ 1.0 to 1.0 and ≤ 1.5 to 1.0	115 bps	–
> 1.5 to 1.0	140 bps	25 bps

The Notes and the Bank Facility share security on a pari passu basis with collateral consisting of a fixed and floating charge on the Fund's Canadian assets and guarantees from various subsidiary companies. The Fund is required to maintain certain covenants on the Notes and the Bank Facility. The Fund was in compliance with these covenants at December 31, 2006.

During the third quarter of 2006, the Fund completed the placement of a AUD $10 million credit facility with HSBC Australia. This credit facility may be used for overdraft and letters of credit. HSBC Australia also shares in the collateral consisting of a fixed and floating charge on the Fund's Canadian assets and guarantees from various subsidiary companies. HSBC Australia also has a Parent Guarantee from the Fund.

a) Operating Line

Under the debt restructuring completed on December 20, 2006 there is no longer a split in the Bank Facility between Operating Line and Long-term Debt. The Bank Facility currently matures on June 30, 2009 but is extendible at the option of the banks. All the drawings on the Bank Facility are classified as Long-term Debt at December 31, 2006.

December 31,	**2006**	2005
Bankers' acceptances – CDN$	**$ –**	$ 18,000
LIBOR borrowing – 2006 – US$0 (2005 – US$11,000)	**–**	12,825
Net overdraft – CDN$ equivalent	**–**	12,485
Operating bank loans	**$ –**	$ 43,310

[1] Earnings before interest, taxes, depreciation and amortization ("EBITDA") is a non-GAAP (Generally Accepted Accounting Principles) earnings measure that does not have a standardized meaning prescribed by GAAP and therefore is unlikely to be comparable to similar measures presented by other issuers.

b) Long-term Debt

At December 31, 2006, $32,967,000 of the $150 million bank facility was drawn. At December 31, 2005, $76,304,000 of the $100 million extendible revolving term loan facility was drawn. Both were financed through LIBOR borrowings, which bear interest at the London Interbank Offer Rate plus a margin, and Canadian dollar BAs, which bear interest at bankers' acceptance rates plus a margin. The composition of the December 31 bank facility borrowings, senior notes and term loan borrowings is as follows:

December 31,	**2006**	2005
Bankers' acceptances – CDN$	**$ –**	$ 32,000
Prime loan – CDN$	**5,000**	–
LIBOR borrowing – 2006 – US$22,000 (2005 – US$38,000)	**25,637**	44,304
U.S. base rate loan – 2006 – US$2,000 (2005 – US$0)	**2,330**	–
Net overdraft – CDN$ equivilent	**–**	–
Total bank facility	**32,967**	76,304
Senior notes due December 20, 2013	**21,000**	–
Senior notes due December 20, 2016	**79,590**	–
Total long-term debt	**133,557**	76,304
Less current portion	**–**	(12,717)
Long-term debt	**$ 133,557**	$ 63,587

Canadian dollar equivalent principal payments which are due over the next three years, without considering renewal at similar terms, are:

2007	$ –
2008	–
2009	32,967
Total	$ 32,967

c) Interest and financing costs on long-term debt were $5,314,220 (2005 – $3,186,547). The Fund's effective interest rate on long-term debt was 6.5% (2005 – 4.8%).

Note 6. Guarantees, Commitments And Contingencies

At December 31, 2006, the Fund had outstanding letters of credit issued in lieu of holdbacks, performance guarantees and bid bonds of $20,057,000 (December 31, 2005 – $25,548,000) of which $1,099,000 (December 31, 2005 – $1,419,000) are insured by Export Development Canada, against wrongful call.

The Company is involved in litigation and claims associated with normal operations against which certain provisions have been made in the financial statements. Management is of the opinion that any resulting net settlement would not materially affect the financial position, results of operations or liquidity of the Fund.

On June 7, 2006, Western Gas Resources, Inc. ("Western"), together with its insurer, commenced arbitration proceedings against Enerflex Systems, Inc. ("ESI"), a wholly owned subsidiary of the Fund.

The arbitration relates to ESI's supply of gas compressor packages to Western in 2001. The amount claimed from ESI in the arbitration proceedings is approximately US$16.1 million. The Fund is currently examining the merits of Western's claims and believes that it has strong defenses to such claims and further believes that the agreements with Western exclude claims for consequential damages.

Aggregate minimum future required lease payments, primarily for operating leases for equipment, automobiles and premises, are $26,329,000 payable over the next five years and thereafter as follows:

2007	$ 9,206
2008	7,921
2009	5,499
2010	2,649
2011	841
Thereafter	213
Total	$ 26,329

In addition, the Fund has purchase obligations over the next three years as follows:

2007	$ 70,462
2008	$ 4,216
2009	$ 19

Note 7. Post Retirement Benefits

Defined Contribution Pension Arrangements

The amount expensed in 2006 under the Fund's defined contribution pension arrangements was $5,120,000 (2005 – $3,315,000). The increase in this expense is the result of the expansion of the Group Retirement Savings Plan for the Fund's Canadian employees and the continued expansion of operations in Australia.

Defined Benefit Pension

The Fund's subsidiary, Landré Ruhaak BV, sponsors a contributory pension plan which provides defined benefit pensions to members working in the Netherlands. The plan provides defined benefit pensions which are based on a member's years of service and final average remuneration.

The Fund retains independent actuaries to value the pension plan's assets and liabilities. The effective date of the most recent valuation was December 31, 2006. The date of the next required valuation is December 31, 2007.

The defined benefit pension plan costs have been determined based on management's best estimate assumptions of the rate of return on plan assets, rate of salary increases and various other factors including mortality, termination and retirement rates.

The following tables detail the changes in the benefit obligation, the fair value of plan assets and the recorded asset or liability for the Fund's defined benefit pension plan.

(Thousands of dollars)	**2006**	2005
Change in Accrued Benefit Obligation		
Accrued benefit obligation, January 1	**$ 3,938**	$ 3,154
Change due to foreign exchange	**449**	–
Current service cost	**275**	202
Plan amendments	**248**	–
Employee contributions	**94**	69
Benefits paid	**(40)**	–
Interest cost	**175**	142
Actuarial (gain) / loss	**944**	371
Accrued benefit obligation, December 31	**$ 6,083**	$ 3,938

Change in Plan Assets		
Fair value of assets, January 1	**$ 3,361**	$ 2,622
Change due to foreign exchange	**381**	–
Employer contributions	**398**	289
Employee contributions	**94**	69
Benefits paid	**(40)**	–
Actual return	**691**	381
Fair value of assets, December 31	**$ 4,885**	$ 3,361

Asset / (Liability)		
Fair value of assets, December 31	**$ 4,885**	$ 3,361
Accrued benefit obligation, December 31	**6,083**	3,938
Funded status	**(1,198)**	(577)
Unamortized transitional obligation	**439**	426
Unamortized actuarial (gain) / loss	**532**	93
Prior service costs	**263**	–
Accrued benefit (liability) / asset	**$ 36**	$ (58)

Net Periodic Pension Expense		
Years Ended December 31,	**2006**	2005
Service cost	**$ 275**	$ 202
Interest cost	**175**	142
Expected return on plan assets	**(157)**	(126)
Amortization of transitional obligation	**119**	106
Amortization of actuarial loss	**8**	23
Amortization of past service costs	**(15)**	–
Net expense	**$ 405**	$ 347

Plan Assumptions

Years Ended December 31,	2006	2005
Expected rate of return on plan assets	**4.50%**	4.00%
Discount rate	**4.50%**	4.00%
Rate of increase in compensation levels	**3.50%**	3.00%

Major Categories of Defined Benefit Pension Plan Assets

The Fund invests in assets that provide security for this pension plan. These assets are currently invested in an annuity contract with Swiss Life.

The weighted average asset allocations at the year-end were as follows:

Asset Category (% of Assets)	2006	2005
Equities	**0%**	0%
Bonds	**0%**	0%
Real estate	**0%**	0%
Other	**100%**	100%
Total	**100%**	100%

Note 8. Income Taxes

The provision for income taxes differs from that which would be expected by applying statutory rates. A reconciliation of the difference is as follows:

Years Ended December 31,	2006	2005
Income before income taxes	**$ 59,255**	$ 60,615
Canadian statutory rate	**32.50%**	33.62%
Expected income tax provision	**$ 19,258**	$ 20,379
Add (deduct)		
Income taxed in foreign jurisdictions	**$ 340**	$ (204)
Other	**(1,094)**	348
Income tax provision	**$ 18,504**	$ 20,523

The composition of the income tax provision is as follows:

Years Ended December 31,	2006	2005
Current income taxes	**$ 20,710**	$ 23,595
Future income taxes	**(2,206)**	(3,072)
Income tax provision	**$ 18,504**	$ 20,523

The computation of the Fund's provision for income taxes involves tax interpretations, regulations and legislation that are continually changing. There are tax matters that have not yet been confirmed by the various tax authorities; however, management believes that the provision for income taxes is adequate.

The tax effect of the significant components of temporary differences that give rise to future income tax assets and liabilities as at year end are as follows:

December 31,	2006		2005	
	Assets	**Liabilities**	Assets	Liabilities
Current:				
Provisions	**$ 4,876**	**$ –**	$ 3,983	$ –
	4,876	**–**	3,983	–
Long-term:				
Provision	**325**	**910**	283	2,946
Tax losses	**2,663**	**–**	1,436	–
Capital assets	**2,517**	**12,760**	3,149	10,096
	5,505	**13,670**	4,868	13,042
	$ 10,381	**$ 13,670**	$ 8,851	$ 13,042

The Fund has available tax losses in its U.S. subsidiary totalling $6,828,000; however, in the determination of its future income tax assets the Fund has only recognized the benefit on $3,418,000 of the losses in the accounts, based on the expectation of the utilization of such losses.

Current future income tax assets result from deductible temporary differences between the tax basis of the Fund's current assets and liabilities and their carrying amounts. These relate primarily to provisions for overhaul, doubtful accounts receivable and warranty expense.

Long-term future income tax assets result from deductible temporary differences between the tax basis of the Fund's property, plant and equipment and its carrying amount and non-capital loss carryforwards not expected to be utilized in the following year.

Long-term future income tax liabilities result primarily from taxable temporary differences between the tax basis of the Fund's rental equipment and its carrying amount.

On October 31, 2006 the Finance Minister of the Government of Canada announced proposed changes to the Income Tax Act of Canada which, if enacted, could result in the imposition of a form of income tax on Income Trusts and Limited Partnerships. Though exact details are not known at this time, the Minister did state there would be a transition period of four years for existing trusts. As such, it is not believed that this announcement will impact the Fund during the next four years. The Fund will monitor this situation closely and implement appropriate strategies to minimize the effect of such actions should legislation develop.

Note 9. Unitholder Capital

On October 2, 2006, Enerflex was reorganized into an open-ended mutual fund trust. Shareholders of Enerflex exchanged their common shares for Trust Units and/or Class B exchangeable limited partnership units ("exchangeable LP units" or "LP units") of a limited partnership indirectly owned by the Fund.

Authorized:

The Fund is authorized to issue an unlimited number of trust units and ordinary and exchangeable LP units.

Common Shares

	Common Shares	Amount
Balance, December 31, 2004	22,337,438	$ 178,540
Stock options exercised	148,276	2,769
Shares issued on acquisition (net of issuance costs)	122,176	2,842
Balance, December 31, 2005	22,607,890	$ 184,151
Stock options exercised	769,714	$ 21,622
Shares purchased and cancelled	(26,500)	(319)
Balance, October 2, 2006	**23,351,104**	**$ 205,454**

In December 2005, Enerflex issued a Normal Course Issuer Bid to purchase up to 1,130,313 common shares, expiring on December 4, 2006. The issuer bid expired upon completion of the Arrangement at which time Enerflex had purchased 38,900 common shares under this Issuer Bid in 2006, 26,500 of which had been cancelled.

On October 2, 2006, all outstanding common shares converted on a two for one basis resulting in 43,071,052 Trust Units and 3,631,156 Exchangeable LP Units being issued.

Trust Units

	Trust Units	Amount
Balance, October 2, 2006	–	$ –
Issued pursuant to the Arrangement	43,071,052	189,480
Redeemed LP units	5,602	25
Trust units cancelled	(24,800)	–
Balance, December 31, 2006	**43,051,854**	**$ 189,505**

Exchangeable LP Units

Exchangeable LP Units carry the same voting privileges and are economically equivalent to the units of the Fund. The LP Units are redeemable on a one-to-one basis at the discretion of the of the holder after July 2, 2007 or earlier at the discretion of the Fund. All LP units are automatically redeemed for trust units on the fifth anniversary of the Arrangement.

	LP Units	Amount
Issued pursuant to the Arrangement	3,631,156	$ 15,974
LP Units redeemed	(5,602)	(25)
Balance, December 31, 2006	**3,625,554**	**$ 15,949**

Summary

	Units	Amount
Trust units	43,051,854	$ 189,505
Exchangeable LP units	3,625,554	15,949
Balance, December 31, 2006	**46,677,408**	**$ 205,454**

Unitholder Rights Plan

Upon the conversion to an income trust, the Fund implemented a unitholder rights plan (the "Rights Plan"). The Rights Plan was designed to conform to current unitholder rights plan design practices prevalent for Canadian issuers. The Rights Plan was confirmed by the Toronto Stock Exchange and the unitholders of the Fund.

The primary objectives of the Rights Plan are to ensure that, in the context of a bid for control of the Fund through an acquisition of Fund Units, the Board of Directors has sufficient time to explore for and develop alternatives for maximizing unitholder value, to provide adequate time for competing bids to emerge, to ensure that unitholders have an equal opportunity to participate in such a bid and have adequate time to properly assess the bid and to lessen the pressure to tender typically encountered by a unitholder of a trust that is subject to a bid. The Rights Plan utilizes the mechanism of the Permitted Bid to ensure that a person seeking control of the Fund allows unitholders and the Board of Directors sufficient time to evaluate the bid. The purpose of the Permitted Bid is to allow a potential bidder to avoid the dilutive features of the Rights Plan by making a bid that conforms with the conditions specified in the Permitted Bid provisions. If a person makes a takeover bid that is a Permitted Bid, the Rights Plan will not affect the transaction in any respect.

Note 10. Contributed Surplus

Charges and credits to contributed surplus are related to stock/trust unit options and are as follows:

Opening balance, January 1, 2005	$ 1,203
Compensation expense	849
Options exercised	(313)
Closing balance, December 31, 2005	1,739
Compensation expense	4,475
Options exercised	(6,214)
Balance October 1, 2006 prior to Arrangement	–
Compensation expense subsequent to Arrangement	71
Closing balance, December 31, 2006	**$ 71**

Note 11. Stock/Unit-based Compensation

a) Stock / Trust Unit Options

Stock Options

Stock options entitled the option holder to acquire common shares of Enerflex's stock at the strike price, established at the time of grant, after vesting and before expiry. The exercise price of each option was equal to the average of the market price of Enerflex's shares on the five days preceding the effective date of the grant. The options normally vested at a rate of 20% on each of the five anniversaries of the date of the grant and expire on the tenth anniversary.

During 2006, Enerflex granted 139,980 stock options at a weighted-average exercise price of $32.07. During 2006, 27,460 stock options were converted to Phantom Shares.

Upon approval of the Arrangement by security holders of Enerflex and the Court of Queen's Bench of Alberta on September 27, 2006, all outstanding stock options were vested and the full liability accrued. This resulted in the exercising of 618,455 "in-the-money" stock options. The remaining 308,734 stock options were cancelled and settled at a value of $0.01 per option. This resulted in Enerflex having no outstanding stock options as of September 30, 2006.

Stock options outstanding are as follows:

	October 2, 2006		December 31, 2005	
	Options	**Weighted Average Exercise Price**	Options	Weighted Average Exercise Price
Outstanding, beginning of period	**1,128,658**	**$ 22.78**	1,062,772	$ 20.94
Granted	**139,980**	**32.07**	292,362	26.69
Exercised	**(769,714)**	**20.02**	(148,276)	16.56
Forfeited	**(498,924)**	**29.64**	(55,400)	23.04
Expired	**–**	**–**	(22,800)	26.92
Outstanding, end of period	**–**	**$ –**	1,128,658	$ 22.78
Options exercisable, end of period	**–**		440,189	

Trust Unit Options

A trust unit option entitles the option holder to acquire units of the Fund at the strike price, established at the time of grant, after vesting and before expiry. The exercise price of each option equals the weighted average of the market price of the Fund's units on the five days preceding the effective date of the grant. The options normally vest at a rate of one third on each of the three anniversaries of the date of grant and expire on the fifth anniversary.

At December 31, 2006, the Fund has reserved 2,366,420 units under the terms of the trust unit option plan, of which 1,962,570 were available for issuance at December 31, 2006.

On October 4, 2006, the Fund issued 403,850 unit options to employees and directors at an exercise price of $13.66.

Trust unit options outstanding are as follows:

	December 31, 2006	
	Options	**Weighted Average Exercise Price**
Outstanding, beginning of period	**–**	**$ –**
Granted	**403,850**	**13.66**
Exercised	**–**	**–**
Forfeited	**–**	**–**
Expired	**–**	**–**
Outstanding, end of period	**403,850**	**$ 13.66**
Options exercisable, end of period	**19,350**	

The estimated fair value of the options used for accounting purposes has been determined using a modified Black-Scholes option pricing model with the following assumptions:

	Post- Arrangement 2006	Pre- Arrangement 2006	Year ended December 31, 2005
Weighted average risk-free interest rate	3.9%	4.2%	3.8%
Weighted average expected life (in years)	4.0	4.0	5.5
Estimated volatility in the market price of the common shares	29.2%	30.7%	33.1%
Expected dividend yield	9.2%	1.6%	1.5%
Calculated weighted average fair value per option	$ 1.47	$ 8.46	$ 8.33

b) Share/Trust Units

Share Units

A Restricted Share Unit ("RSU") or Deferred Share Unit ("DSU") entitled the holder to receive a payment, as described below, from the Company equal to the implied market value calculated as the number of units multiplied by the closing price of Enerflex common shares on the entitlement date.

RSUs were granted to eligible participants on an annual basis and generally vested on the third anniversary date the grant subject to the achievement of any performance criteria which may have been, at the discretion of the Company, attached as a condition of vesting at the date of grant. Performance criteria may have included such performance measures as earnings per share or return on capital employed, either for the Company as a whole, or a portion thereof. Vested RSUs were to be settled by the end of the year following the year in which vesting occurred. The Company may have, at its sole discretion, satisfied, in whole or in part, its payment obligation through a cash payment to the participant or by instructing an independent broker to acquire a number of fully paid shares in the open market on behalf of the participant.

DSUs were granted to eligible participants on an annual basis and generally vested on the fifth anniversary date of the grant subject to the achievement of any performance criteria which may have been, at the discretion of the Company, be attached as a condition of vesting at the date of grant. Performance criteria may have included such performance measures as earnings per share or return on capital employed, either for the Company as a whole, or a portion thereof. Vested DSUs were to be settled in cash, payable to the participant by the end of the year following the year in which their employment is terminated through departure, retirement or death.

The number of DSUs granted to an individual participant was limited, in the case of the initial grant, to an aggregate market value of the grant not in excess of 100% of the participant's regular annualized salary and, in the case of subsequent grants, to an aggregate market value of the grant not in excess of 50% of the participant's annualized salary and cash bonuses for the twelve months preceding the grant date.

RSU and DSU recipients were entitled to additional units over and above those initially granted based on the notional number of shares that could have been purchased using the proceeds of notional dividends, that would have been received had the units then subject to vesting been actual common shares of the Company, following each dividend paid to the Shareholders of the Company.

Both RSUs and DSUs represented an indexed liability of the Company relative to the Company's share price.

As of September 30, the Company had issued a total of 7,000 RSUs during 2006. Of these RSUs, 50% were subject to sliding scale performance criteria based on the increase in Return on Capital Employed ("ROCE") in fiscal 2006 over that achieved in fiscal 2005. An increase in ROCE of 0.0%, or less, will result in 0% of the units subject to performance criteria being eligible for vesting. An increase in ROCE of 2.0%, or better, will result in 100% of the units subject to performance criteria being eligible for vesting. Each 0.1% increment between 0.0% and 2.0% in the change in ROCE increases the number of units eligible for vesting by 5%.

Upon approval of the Arrangement by security holders of the Company and the Court of Queen's Bench of Alberta on September 27, 2006, all outstanding RSUs and DSUs were vested and the full liability paid. This resulted in the vesting of a total of 219,354 RSUs and 16,174 DSUs.

Restricted share units outstanding as of October 2, 2006 are as follows:

	Not Subject to Performance Criteria	In Lieu of Distributions	Subject to Performance Criteria	In Lieu of Distributions	Weighted Average Grant Date Fair Value per Unit
Outstanding, beginning of period	119,460	1,473	104,637	785	$ 24.71
Granted	3,500	1,122	3,500	1,110	$ 29.66
Exercised	(114,820)	(2,535)	(100,336)	(1,663)	$ 24.56
Forfeited	(8,140)	(60)	(7,801)	(232)	$ 29.02
Performance criteria not met	–	–	–	–	$ –
Outstanding, end of period	**–**	**–**	**–**	**–**	**$ –**

Deferred share units outstanding as of October 2, 2006 are as follows:

	Not Subject to Performance Criteria	In Lieu of Distributions	Subject to Performance Criteria	In Lieu of Distributions	Weighted Average Grant Date Fair Value per Unit
Outstanding, beginning of period	15,000	641	312	8	$ 16.75
Granted	–	210	–	3	$ 27.67
Exercised	(15,000)	(851)	(312)	(11)	$ 16.89
Forfeited	–	–	–	–	$ –
Performance criteria not met	–	–	–	–	$ –
Outstanding, end of period	**–**	**–**	**–**	**–**	**$ –**

Trust Units

A Restricted Trust Unit ("RTU") or Performance Trust Unit ("PTU") entitles the holder to receive a payment, as described below, from the Fund equal to the implied market value calculated as the number of units multiplied by the closing price of Enerflex trust units on the entitlement date.

RTUs may be granted to eligible participants on an annual basis and will generally vest on the third anniversary date of the grant . However, the Fund may, at its sole discretion, permit the annual vesting of such RTUs on the date of grant. Vested RTUs are to be settled by the end of the year vesting occurs. The Fund may at its sole discretion, satisfy, in whole or in part, its payment obligation through a cash payment to the participant or by instructing an independent broker to acquire a number of fully paid trust units in the open market on behalf of the participant.

PTUs may be granted to eligible participants on an annual basis and will generally vest on the third anniversary date of the grant subject to the achievement of any performance criteria which may have been, at the discretion of the Fund, be attached as a condition of vesting at the date of grant. Performance criteria may include such performance measures as earnings per share or return on capital employed, either for the Fund as a whole, or a portion thereof. Vested PTUs are to be settled by the end of the year in which vesting occurs. The Fund may at its sole discretion, satisfy, in whole or in part, its payment obligation through a cash payment to the participant or by instructing an independent broker to acquire a number of fully paid trust units in the open market on behalf of the participant.

RTU and PTU recipients are entitled to receive additional units over and above those initially granted. These additional units are based on the notional amount of units that could have been purchased using the proceeds of notional distributions that would have been received had the units been actual trust units of the Fund. The additional units are calculated with each distribution declared by the Fund.

Both RTUs and PTUs represent an indexed liability of the Fund relative to the Fund's unit price.

On October 4, 2006, the Fund granted 130,937 RTUs and 140,351 PTUs to employees of the Fund. The PTUs are subject to sliding scale performance criteria based 75% on the Return on Capital Employed ("ROCE") in fiscal 2007 and 25% on the achievement of established quality targets for the Fund.

Trust units outstanding as of December 31, 2006 are as follows:

	RTU	In Lieu of Distributions	PTU	In Lieu of Distributions	Weighted Average Grant Date Fair Value per Unit
Outstanding, beginning of period	–	–	–	–	$ –
Granted	130,937	2,973	140,351	3,187	$ 13.57
Exercised	–	–	–	–	$ –
Forfeited	–	–	–	–	$ –
Performance criteria not met	–	–	–	–	$ –
Outstanding, end of period	**130,937**	**2,973**	**140,351**	**3,187**	**$ 13.57**

c) Phantom Share/Unit Plan

Phantom Share Plan

During 2005, the Board of Directors approved the adoption of a Phantom Share Plan (Stock Appreciation Right) ("SAR") for the purpose of providing stock-based compensation incentives to certain employees in jurisdictions outside of Canada.

The exercise price of each SAR equals the average of the market price of the Company's shares on the five days preceding the date of grant. The SARs normally vest at a rate of 20% on each of the five anniversaries of the date of grant and expire on the tenth anniversary. The award entitlements for increases in the common share trading value of Enerflex Systems Ltd. are to be paid to the recipient in cash upon exercise.

During 2006, 27,450 stock options were converted to SARs resulting in a total of 60,100 outstanding SARs as at September 27, 2006.

Upon approval of the Arrangement by security holders of the Company and the Court of Queen's Bench of Alberta on September 27, 2006, all outstanding SARs were vested and the full liability paid. This resulted in the vesting of 45,900 "In-the-money" SARs. The remaining 14,200 SARs were cancelled and settled at a value of $0.01 per SAR.

	Phantom Units	Weighted Average Exercise Price
Outstanding, December 31, 2004	–	$ –
Granted	32,650	27.02
Exercised	–	–
Forfeited	–	–
Expired	–	–
Outstanding, December 31, 2005	32,650	$ 27.02
Converted stock options	27,450	20.52
Granted	–	–
Exercised	(45,900)	22.49
Forfeited	–	–
Expired	(14,200)	29.08
Outstanding, October 2, 2006	–	$ –

Phantom Trust Unit Plan

During 2006, the Board of Directors approved the adoption of a Phantom Trust Unit Plan (Unit Appreciation Right) ("UAR") for the purpose of providing unit-based compensation incentives to certain employees in jurisdictions outside of Canada.

The exercise price of each UAR equals the average of the market price of the Fund's units on the five days preceding the date of grant. The UARs normally vest at a rate of one third on each of the three anniversaries of the date of grant and expire on the fifth anniversary. The award entitlements for increases in the trust unit trading value of Enerflex Systems Income Fund are to be paid to the recipient in cash upon exercise.

On October 4, 2006, the Board of Directors approved the grant of 7,575 UARs, to certain employees resident outside of Canada, at an exercise price of $13.66.

Phantom trust units outstanding are as follows:

	Phantom Units	Weighted Average Exercise Price
Outstanding, beginning of year	–	$ –
Granted	7,575	13.66
Exercised	–	–
Forfeited	–	–
Expired	–	–
Cancelled	–	–
Outstanding, end of year	**7,575**	**$ 13.66**

d) Stock/Unit Based Compensation Expense

The stock/unit based compensation expense included in the determination of net income is:

Years Ended December 31,	**2006**	2005
Stock options	**$ 4,475**	$ 849
Share units	**5,295**	1,224
Phantom shares	**392**	1
Trust unit options	**71**	–
Restricted and performance trust units	**341**	–
Total	**$ 10,574**	$ 2,074

Note 12. Reconciliation Of Earnings Per Share/Unit Calculations

Per share/unit amounts have been restated to reflect the two for one unit split on October 2, 2006 as part of the Arrangement.

Years Ended December 31,	**2006**			2005		
	Net Income	**Weighted Average Units/Shares Outstanding**	**Per Unit**	Net Income	Weighted Average Shares Outstanding	Per Share
Basic	**$ 40,751**	**45,710,389**	**0.89**	$ 40,092	45,039,952	$ 0.89
Options assumed exercised		**1,152,149**			1,369,892	
Units assumed purchased		**(984,526)**			(1,146,616)	
Diluted	**$ 40,751**	**45,878,012**	**0.89**	$ 40,092	45,263,228	$ 0.89

Note 13. Financial Instruments

Foreign Currency – In the normal course of operations, the Fund is exposed to movements in the U.S. dollar, the Australian dollar, the Pound Sterling, the EURO, the Pakistani rupee and the Indonesian rupiah. The Fund does not hedge the net investment exposure in foreign subsidiaries.

The Fund also enters into contracts denominated in currencies other than Canadian dollars for the export of goods from its Canadian facilities, usually in U.S. dollars. In order to mitigate the exposures from such contracts, the Fund matches future foreign currency cash inflows with foreign currency denominated liabilities, primarily through the currency mix in short and long-term borrowings.

From time to time, the Fund also utilizes financial instruments to create offsetting positions to specific exposures. These instruments are employed in connection with an underlying asset, liability or anticipated transaction, and are not used for speculative purposes.

Credit Risk – A substantial portion of the Fund's accounts receivable are with customers in the oil and gas industry and are subject to normal industry credit risks. The carrying amount of accounts receivable reflects management's assessment of the credit risk associated with these customers.

Interest Rate Risk – The Fund's liabilities include certain long-term debt and bank indebtedness that are that are subject to fluctuations in interest rates. For each 1.0% change in the rate of interest on these loans, the change in interest expense would be approximately $330,000, based upon the loan balances at December 31, 2006.

Fair Values of Financial Assets and Liabilities – The fair values of financial instruments that are included in the consolidated balance sheets, other than long-term debt , approximate their carrying amounts due to the short-term maturity of those instruments. The fair value of long-term debt does not differ significantly from its carrying amount.

Note 14. Reorganization Costs

The Fund incurred $9,713,000 in costs related to the conversion of Enerflex from a corporate structure into a mutual fund trust. The components of these costs are as follows:

Accelerated stock-based compensation	$ 7,622
Consulting and advisory fees	1,284
Legal fees	588
Regulatory fees	219
Total	$ 9,713

Included in the $7,622,000 of accelerated stock-based compensation costs was $3,454,000 of non-cash expenses related to accelerated expensing of outstanding stock options.

Note 15. Supplemental Cash Flow Information

Supplemental disclosure of cash flow information

Years Ended December 31,	2006	2005
Interest paid	**$ 7,267**	$ 5,069
Interest received	**$ 646**	$ 333
Income taxes paid	**$ 26,068**	$ 23,544
Income taxes received	**$ 820**	$ 1,599
Cash provided (used) through changes in non-cash working capital		
Accounts and taxes receivable	**$ 6,642**	$ (30,925)
Inventory	**(28,448)**	(21,202)
Accounts, taxes payable and accrued liabilities	**(3,139)**	19,490
Foreign currency and other	**(9,361)**	(2,334)
	$ (34,306)	$ (34,971)
Resulting from operations	**$ (42,388)**	$ (29,873)
Resulting from investing	**(2,033)**	(3,665)
Resulting from financing	**10,115**	(1,433)
	$ (34,306)	$ (34,971)

Note 16. Related Parties

For the years ended December 31, 2006 and 2005, Total Production Services Inc. ("Total") was an influenced investee by virtue of the Fund's 40% investment in Total. All transactions occurring with Total were in the normal course of business operations under the same terms and conditions as transactions with unrelated companies. A summary of the financial statement impact of all transactions with Total, is as follows:

	2006	2005
Revenue	$ 233	$ 2
Management fee	$ 506	$ –
Purchases	$ 1,146	$ –
Accounts receivable balance at December 31	$ 37	$ 1
Accounts payable balance at December 31	$ 42	$ –

Note 17. Interest in Joint Venture

The Fund proportionately consolidates its 46.5% interest in the assets, liabilities, results of operations and cash flows of its joint venture in Pakistan, Presson Descon International (Private) Limited. That 46.5% interest includes:

Balance Sheet	2006	2005
Current assets	$ 1,168	$ 558
Long-term assets	150	147
Current liabilities	–	409
Long-term liabilities and equity	$ 1,318	$ 296
Income Statement		
Revenue	$ 323	$ 858
Expenses	(713)	1,592
Net income	$ 1,036	$ (734)
Cash Flows		
From operations	$ 74	$ (693)
From financing activities	(33)	(18)
From investing activities	$ (18)	$ (26)

Note 18. Segmented Information

The Fund has three reportable segments: Service, Engineered Systems (formerly Fabrication) and Production Services (formerly Leasing). The Service reportable segment is the aggregation of the Mechanical Service and Syntech divisions. The Engineered Systems reportable segment is the aggregation of the Production and Processing and Compression and Power divisions.

	Service ($)		Engineered Systems ($) formerly known as 'Fabrication'		Production Services ($) formerly known as 'Leasing'		Consolidated ($)	
Years Ended December 31,	**2006**	2005	**2006**	2005	**2006**	2005	**2006**	2005
Segment revenue	**$ 307,644**	$ 283,454	**$ 500,459**	$ 393,703	**$ 35,988**	$ 31,563	**$ 844,091**	$ 708,720
Intersegment revenue	**(14,477)**	(15,411)	**(37,263)**	(22,551)	**(21)**	(146)	**(51,761)**	(38,108)
External revenue	**293,167**	268,043	**463,196**	371,152	**35,967**	31,417	**792,330**	670,612
Gross Margin	**82,444**	74,567	**71,391**	51,143	**21,435**	20,235	**175,270**	145,945
Depreciation and amortization	**3,747**	3,424	**7,555**	5,236	**8,822**	7,479	**20,124**	16,139
Income (loss) before interest and income taxes	**26,391**	23,208	**29,301**	22,460	**20,612**	19,588	**76,304**	65,256
Trust conversion costs							**(9,713)**	–
							66,591	65,256
Segment assets	**144,189**	128,199	**206,999**	203,365	**120,625**	102,006	**471,813**	433,570
Corporate							**22,157**	9,367
Goodwill	**50,801**	52,195	**67,047**	61,827	**7,356**	7,356	**125,204**	121,378
Total segment assets	**194,990**	180,394	**274,046**	265,192	**127,981**	109,362	**619,174**	564,315
Segment capital expenditures	**2,530**	$ 4,672	**5,984**	$ 4,758	**34,944**	$ 23,448	**43,458**	32,878
Corporate capital expenditures							**8,246**	881
							51,704	33,759
Segment proceeds on disposal of assets	**$ 812**	1,178	**$ 66**	148	**$ 17,622**	17,650	**$ 18,500**	$ 18,976
Corporate proceeds on disposal of assets							**7,713**	–
							$ 26,213	$ 18,976

Revenue from foreign countries was:

Years ended December 31,	2006	2005
Australia	$ 140,359	$ 53,124
Egypt	26,130	15,851
Indonesia	10,971	11,352
Netherlands	19,856	20,120
Pakistan	5,406	13,045
United States	35,381	23,951
Other	41,242	39,884
	$ 279,345	$ 177,327
Included in these amounts are gross exports from domestic operations of:	$ 104,353	$ 83,875

Revenue is attributed to countries by the destination of the sale.

Revenue from one customer represents approximately $84.9 million or 11% (2005 – $62.0 million, 9%) of the Fund's total revenues for 2006 across all segments.

Total assets in foreign countries were as follows:

	December 31, 2006			December 31, 2005		
	Capital Assets & Goodwill	Other Assets	Total Assets	Capital Assets & Goodwill	Other Assets	Total Assets
Australia	$ 21,839	32,291	$ 54,130	$ 15,261	$ 30,241	$ 45,502
Netherlands	4,135	14,381	18,516	4,069	13,352	17,421
United States	9,224	4,895	14,119	9,255	7,116	16,371
Other			12,482			7,997
Total assets			$ 99,247			$ 87,291

Total assets are attributed to countries by the location of the business.

Note 19. Subsequent Event

Acquisition of the assets of Powetec Beheer B.V.

On January 30, 2007, Enerflex entered into an agreement with the shareholders of the Netherlands based Powertec Beheer B.V. ("Powertec"), whereby Enerflex acquired the operating assets of Powertec. Powertec adds power systems manufacturing and Combined Heat and Power expertise, strong gas engine aftermarket capability and a significant base of long-term service contract revenue to the Fund's existing European operations. Powertec generated revenue of approximately $56 million in 2006.

Final purchase costs are still being accumulated and therefore a purchase price allocation cannot be determined at this time.

Ten Year Historical Review

(Millions except per share/unit data and ratios)

(Unaudited)	**2006**	2005	2004	2003	2002	2001	2000	1999	1998	1997
Results										
Revenue	**792.3**	670.6	557.1	515.5	326.7	375.0	286.3	256.7	314.5	336.2
EBITDA[1]	**86.7**	81.4	68.2	51.2	30.0	47.8	28.9	29.1	42.4	46.7
Income before income taxes	**59.3**	60.6	49.2	31.2	14.3	36.5	17.7	20.4	38.1	42.7
Net income	**40.8**	40.1	32.1	20.4	9.2	22.5	11.3	12.1	22.6	25.2
Per share/unit - basic ($)	**0.89**	0.89	0.72	0.46	0.26	0.76	0.38	0.41	0.75	0.84
Interest expense (income)	**7.3**	4.6	3.8	5.3	3.6	2.7	3.6	1.9	(0.3)	(0.1)
Depreciation and amortization	**20.1**	16.1	15.1	14.7	12.1	8.6	7.6	6.8	4.6	4.1
Cash from operations	**15.6**	21.5	50.9	34.1	36.3	29.1	16.2	5.3	1.4	29.9
Capital expenditures, net										
Rental equipment	**14.1**	5.3	21.6	3.7	8.5	10.0	7.9	5.6	10.2	0.6
Property, plant and equipment	**11.4**	9.5	8.8	2.8	2.2	2.5	4.3	14.8	23.5	3.3
Dividends/distributions on shares/units	**20.2**	9.0	8.9	8.9	7.4	6.0	6.0	6.0	6.0	4.5
Financial Position										
Working capital	**200.0**	112.2	85.9	82.8	68.7	62.1	57.9	60.0	56.0	58.0
Rental equipment	**106.1**	90.3	88.8	71.8	68.1	39.0	31.7	26.0	22.2	13.4
Property, plant and equipment	**73.7**	69.0	65.8	65.0	70.3	45.1	47.3	47.7	36.7	16.2
Total assets	**619.2**	564.3	486.9	457.7	451.2	222.1	192.7	186.1	159.5	142.7
Long-term debt	**133.6**	76.3	64.0	68.4	69.0	30.0	30.0	30.0	15.2	–
Unitholder equity	**373.0**	329.3	297.9	274.5	260.9	118.5	104.1	103.0	100.1	87.0
Key Ratios										
Gross margin as a percentage of revenue	**22.1**	21.8	22.5	20.2	21.4	19.5	18.8	19.8	22.4	21.7
Pre-tax income as a percentage of revenue	**7.5**	9.0	8.8	6.1	4.4	9.7	6.2	8.0	12.1	12.7
Return of average equity (%)[2]	**11.6**	12.8	11.2	7.6	4.9	20.2	10.9	11.9	24.1	32.9
Return on capital employed (%)[3]	**14.0**	15.8	14.0	10.0	6.9	24.0	13.9	15.7	36.7	54.6

[1] EBITDA is a non-GAAP earnings measure that does not have a standardized meaning prescribed by GAAP and therefore is unlikely to be comparable to similar measures presented by other issuers. Enerflex calculates EBITDA as follows:

EBITDA for the year ended December 31, 2006: (Thousands)	
Earnings before interest and income taxes	$ 66,591
Depreciation and amortization	20,124
EBITDA	$ 86,715

[2] Return on average equity is calculated as net income divided by the simple average unitholders' equity at the beginning and end of the year.

[3] Return on capital employed is calculated as net income plus interest expense divided by the simple average of capital employed at the beginning of the year and at the end of each quarter. Capital employed is the sum of the unitholders' equity plus current and long-term bank indebtedness.

Quarterly Data

(Unaudited)	2006				2005			
(Millions, except per share/unit data)	**Q4**	**Q3**	**Q2**	**Q1**	Q4	Q3	Q2	Q1
Revenue	**191.2**	**194.2**	**200.1**	**206.8**	203.1	162.7	157.1	147.7
EBITDA[1]	**19.2**	**14.9**	**25.6**	**27.1**	25.1	20.7	19.3	16.2
Income before income taxes	**11.0**	**8.0**	**19.5**	**20.7**	19.3	15.1	14.8	11.4
Net income	**10.7**	**4.7**	**12.5**	**12.9**	13.7	9.8	9.2	7.4
per share/unit – basic	**0.23**	**0.11**	**0.28**	**0.29**	0.31	0.22	0.21	0.17
Depreciation and amortization	**5.9**	**5.1**	**4.6**	**4.6**	4.3	4.3	3.6	3.9
Cash from operations	**12.0**	**(14.5)**	**6.2**	**11.8**	2.8	11.0	9.2	(1.5)
Capital expenditures, net								
Rental equipment	**0.8**	**13.6**	**(2.7)**	**2.4**	2.5	3.0	1.1	(1.4)
Property, plant and equipment	**(2.8)**	**1.8**	**8.1**	**4.3**	2.6	3.0	2.1	1.8
Dividends/distributions on shares/unit	**11.7**	**2.9**	**2.8**	**2.8**	2.3	2.3	2.2	2.2
Dividends/distributions per common share/unit (¢)	**0.25**	**6.3**	**6.3**	**6.3**	5.0	5.0	5.0	5.0
Pre-tax income as a % of revenue	**5.8**	**4.1**	**9.7**	**10.0**	9.5	9.3	9.4	7.7

Common Share/Unit Data

		2006	2005	2004	2003	2002	2001
Trading price range of common stock/units :	– high	**17.34**	14.98	13.15	10.10	13.25	16.20
	– low	**8.75**	10.88	4.63	6.03	6.60	9.30
	– close	**11.05**	13.42	11.78	10.10	7.50	9.88
Trading volume (millions)		**20.4**	18.2	19.0	17.8	14.0	10.4
Common shares/units (millions)							
Outstanding at end of period		**46.7**	45.2	44.6	44.4	44.4	29.8
Weighted average – basic		**45.7**	45.0	44.6	44.4	36.4	29.8

[1] Earnings before interest, income taxes and depreciation and amortization (EBITDA) is a non-GAAP (Generally Accepted Accounting Principals) earnings measure that does not have a standardized meaning prescribed by GAAP and therefore is unlikely to be comparable to similar measures presented by other issuers.

Enerflex calculates EBITDA as follows ($thousands):	**2006**
Income before interest and income taxes	66,591
Depreciation and amortization	20,124
EBITDA	86,715

corporate directory

Directors and Officers [4]

P. John Aldred
Director
Officer of the Corporation
Executive Chairman
Enerflex Systems Ltd.
Calgary, AB

Patrick D. Daniel [2]
Independent Director
President and
Chief Executive Officer
Enbridge Inc.
Calgary, AB

J. Blair Goertzen
Director
Officer of the Corporation
President and
Chief Executive Officer
Red Deer, AB

Douglas J. Haughey [3]
Independent Director
President
Spectra Energy
Transmission West
Calgary, AB

Robert B. Hodgins [1]
Independent Director
Investor and
Corporate Director
Calgary, AB

Geoffrey F. Hyland [1,2]
Independent Director
Consultant and
Corporate Director
Caledon, ON

Nancy M. Laird [1,3]
Independent Director
Investor and
Corporate Director
Calgary, AB

J. Nicholas Ross [1,3]
Independent Director
Chairman and
Chief Executive Officer
Rover Capital Corporation
Toronto, ON

Robert C. Williams [2]
Independent Lead Director
Managing Director
Equity Capital Markets
and Syndication
Scotia Capital Inc.
Toronto, ON

Leonard A. Cornez
Officer of the Corporation
Vice-President and
Chief Financial Officer
Calgary, AB

Rachel M. Moore
Officer of the Corporation
Vice-President
Human Resources
and Privacy Officer
Calgary, AB

William A. Moore
Officer of the Corporation
Sr. Vice-President
Operations
Calgary, AB

Yves J. Tremblay
Officer of the Corporation
Vice-President
Electrical Instrumentation
and Control
Calgary, AB

Sean R. Ulmer
Officer of the Corporation
Vice-President
Production Services
Calgary, AB

[1] Audit Committee

[2] Corporate Governance Committee

[3] Human Resources and Compensation Committee

[4] As at February 28, 2007

Office

Enerflex Systems Income Fund
4700-47 Street SE
Calgary, AB T2B 3R1
Tel: 1.403.236.6800
Fax: 1.403.236.6816
Email: ir@enerflex.com
Website: www.enerflex.com

Whistleblower Contact

North America: 1.866.294.5561
The Netherlands: 0800.0226174
Australia: 1.800.339276
www.ethicspoint.com

unitholder information

Trust Units
The trust units of the Fund are listed and traded on the Toronto Stock Exchange under the symbol "EFX.UN".

Trustee, Registrar and Transfer Agent
Computershare Trust Company of Canada Calgary AB

For unitholder inquiries:

Computershare Trust Company of Canada
100 University Avenue 9th Floor
Toronto ON M5J 2Y1
Tel: 1.800.564.6253
Fax: 1.866.249.7775
Email: service@computershare.com
Website: www.computershare.com

All questions about accounts, unit certificates or distribution cheques should be directed to the Trustee, Registrar and Transfer Agent.

Auditors
Deloitte & Touche LLP
Calgary AB

Bankers
Canadian Imperial Bank of Commerce
HSBC Bank Canada
The Toronto Dominion Bank
Calgary AB

Solicitors
Bennett Jones LLP
Calgary AB

Investor Information
Rhonda Bennetto,
Manager, Investor Relations
Enerflex Systems Income Fund
4700-47 Street SE
Calgary AB Canada T2B 3R1
Tel: 1.403.236.6800
Email: ir@enerflex.com

Requests for the Fund's Annual Reports, Quarterly Reports and other corporate communications should be directed to the Manager, Investor Relations.

Designed and produced by Merlin Edge Inc.
www.merlinedge.com

Printed in Canada

ENERFLEX SYSTEMS INCOME FUND

4700-47 Street SE Calgary AB Canada T2B 3R1
Tel 1.403.236.6800 Fax 1.403.236.6816

www.enerflex.com